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PENDING NATURAL GAS LEGISLATION

HEARING

BEFORE THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 834, S. 1251, S. 1302, S. 2205, and S. 2285

MAY 20, 1986

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CONTENTS

Page

S. 834 4
S. 1251 22
S. 1302 31
S. 2205 43
S. 2285 51

STATEMENTS

Bailey, Keith E., president, Northwest Central Pipeline Corp 149
Bush, Nicholas J., president, Natural Gas Supply Association 112
Cooper, Dr. Mark N., director of energy, Consumer Federation of America 169
Gentry, Charles R., partner, Shank, Irwin & Conant, on behalf of the Independent Petroleum Association of New Mexico 294
Gooch, Gordon, counsel, Petrochemical Energy Group 237
Graves, Jack, president, Oklahoma Independent Petroleum Association 314
Hargrove, Joseph L., vice president, Louisiana Association of Independent Producers and Royalty Owners 325
Hecht, Hon. Chic, a U.S. Senator from the State of Nevada 64
Herrington, Hon. John S., Secretary, Department of Energy, accompanied by Stepen T. Minihan, Acting Director, Economic Analysis 68
House, David, chairman, natural gas policy committee, Oklahoma Independent Petroleum Association 320
Lawrence, George H., president, American Gas Association 178
McClure, Hon. James A., a U.S. Senator from the State of Idaho 65
Merrels, A.S., director, energy purchases and hydrocarbon ventures, Owens-Corning Fiberglas Corp., on behalf of Process Gas Consumers 247
Nickles, Hon. Don, a U.S. Senator from the State of Oklahoma 1
O'Neill, Brian E., president, Transcontinental Gas Pipe Line Corp., on behalf of Interstate Natural Gas Association of America, accompanied by Keith E. Bailey, president, Northwest Central Pipeline Corp 129
Porter, E.E., director, hydrocarbon supply department, Union Carbide Corp., on behalf of the Petrochemical Energy Group 234
Snyder, Barry L., on behalf of the Independent Petroleum Association of Mountain States 341
Watson, John E., chairman, FERC regulation task force, Texas Independent Producers and Royalty Owners Association 335
Wischer, Irene, chairman, natural gas committee, Independent Petroleum Association of America 284

APPENDIX

Additional material submitted for the record 397

PENDING NATURAL GAS LEGISLATION

TUESDAY, MAY 20, 1986

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 9:05 a.m., in room SD-366, Dirksen Senate Office Building, Hon. Don Nickles presiding.

Present: Senators Nickles, Domenici, Hecht, Evans, and Bumpers.

Also present: Howard Useem, professional staff member; Richard D. Grundy, senior professional staff member; and Elizabeth Moler, counsel for the minority.

OPENING STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator NICKLES. Good morning.

Today we will be having actually the second day of hearings on several natural gas decontrol proposals introduced by myself and also Chairman McClure, Senator Johnston, Senator Hecht, and others dealing with natural gas deregulation. I think it is high time that we do deregulate natural gas. It is one of the few things we can do that would help a very depressed energy industry.

Natural gas is one of the few commodities, if not the only commodity, that is still price regulated by the Federal Government. It has been under Federal price control for over 30 years, and those price controls have greatly exaggerated and exacerbated and misallocated a very precious and valuable natural resource.

I think the deregulation of oil has proven that the marketplace is a much better allocator of resources than the Federal Government. The NGPA and the variety of price schemes we still have presently continuing on the books does distort and misallocate and sends bad signals throughout the marketplace.

We need natural gas deregulation. We have several different proposals, including one that I have introduced. Also, Secretary Herrington has a proposal introduced by Senator McClure that I think has a lot of merit. We will be dealing with almost all the issues, including repeal of the Fuel Use Act in criminal pricing.

We are also looking at decontrol of old gas, the elimination of any end use restraints, and also some carriage provisions that deal with hopefully moving more gas to the marketplace and giving consumers a better price on a commodity.

We have in our State a lot of natural gas that is shut in. That is very unfortunate. We would like to see that gas moved. Whether or not we can come up with a carriage provision that will work, that is a lot easier said than done. We will be discussing a few of those provisions as well.

I am hoping we can come to a consensus, and I say a consensus—I am very serious—in this committee and also in this Congress and the House and the Senate, and have legislation on the President's desk this year.

That is a big order, but the time is now. This industry is hurting, and as I said, this is one of the things we can do to assist the industry and also to assist the consumers. I think there is no question a formal look at the facts of natural gas deregulation can be of benefit for both the industry and consumers as well, so we will be working on that, and hopefully we will be successful this year.

We are pleased that Senator Hecht has joined us this morning. He has been a very faithful member of this committee, and one that also has been interested in finding a free market approach, and I appreciate that as well.

Chic, do you want to make an opening comment?

[The prepared statement of Senater Nickles and the texts of S. 834, S. 1251, S. 1302, S. 2205, and S. 2285 follow:]

STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Ladies and Gentlemen, I am pleased to convene these hearings of the Energy and Natural Resources Committee on Pending Natural Gas Legislation, S. 834, S. 1251, S. 1302, S. 2205, and S. 2285.

I would like to thank Senator McClure for scheduling these hearings because the issue of regulatory reform in the natural gas industry is of great concern, not only to the producers in Oklahoma and other States, but also to the consumers throughout the Nation.

It seems to me that we need to complete the regulatory reform begun with the Natural Gas Policy Act in 1978 and continued with the Fuel Use Act Amendments in 1981 and the successful decontrol of 60 percent of natural gas on January 1, 1985. At a time when our industry is beset by foreign competition, it is very appropriate that we streamline and make our industry more efficient. Our efforts here today can minimize costly bureaucratic redtape and remove impediments to a free natural gas market.

The decontrol provisions under consideration here today will aid conservation and benefit all U.S. citizens by allowing recovery of over 30 trillion cubic feet of old natural gas which would otherwise be lost. Decontrol should also lower the cost of gas to consumers substantially. A new Energy Information Agency Study just released indicates that contrary to the assumption that high priced gas contracts are inflexible downward and that raising the ceilings on low-priced old gas will cause that gas to rise, new and old vintage 107 contract prices are flexible downward and have already dropped considerably. Decontrol legislation can also act as a backup to the DOE old gas devintaging rule should FERC adopt it and it almost surely comes under legal attack.

And by eliminating end use restrictions on natural gas, our national security will be strengthened by less dependence on foreign oil by some 300,000 barrels a day. This in turn should also lower our balance of payments problem by $1 billion to almost $4 billion.

Legislation designed to improve natural gas transportation can strengthen domestic competition and ensure that consumers get access to reasonably priced natural gas. This should lower the cost of goods and services.

To date, it is reported that only one-third of the natural gas pipelines have applied for the nondiscriminatory transportation provisions under FERC's Order 436 and many producers in my native State of Oklahoma are still shut in from last fall. This hurts producers and consumers alike because producers no longer have profits to plow back into exploration to replace current supplies of gas.

I would note that yesterday the rig count hit 757, down from 1,915 at the start of this year and from a peak of 4,530 in 1981. Reasonable transportation legislation can help this problem and act as a backup to Order 436, which is currently under legal attack in the courts.

Ours is not an easy task, however, due to the sometimes diverging interests of the parties at hand. However, because we all share in the common goal of strengthening our national economy and promoting the health and welfare of our citizens, I would ask you all to put aside parochial self interests and work with me in developing a consensus which will not only benefit the producer in Louisiana, Texas, and Oklahoma, and the consumer States such as Illinois, Ohio, New Jersey, and at the same time will also do justice to the transporters and distributors throughout the Nation.

We would task the brainpower assembled in this room to give us your best recommendations as to the legislation we should adopt because as we have learned in the past, Congress cannot do it alone. We need your help.

99TH CONGRESS
1ST SESSION

S. 834

To increase competition in the transportation of natural gas.

IN THE SENATE OF THE UNITED STATES

APRIL 2 (legislative day, FEBRUARY 18), 1985

Mr. BRADLEY introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To increase competition in the transportation of natural gas.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Natural Gas Competition Act of 1985".

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) a national market for natural gas is necessary to promote both lower and nondiscriminatory natural gas prices and reliable supplies; and

(2) transportation of natural gas by interstate pipelines and local distribution companies is an essen-

tial element in establishing a national market for natural gas.

(b) The purposes of this Act are to—

(1) promote development of a national market for natural gas; and

(2) provide lower natural gas prices to consumers on a nondiscriminatory basis by providing competitive alternatives to purchases from interstate pipelines.

SEC. 3. CONTRACT CARRIAGE.

(a) IN GENERAL.—The Natural Gas Policy Act of 1978 (15 U.S.C. 3301 et seq.) is amended by adding the following new section:

"SEC. 316. CONTRACT CARRIAGE.

"(a) GENERAL RULE.—A person subject to this section shall, without discrimination, according to publicly filed tariffs, transport natural gas on the reasonable request of any person to the extent the pipeline, distribution company or gathering system has firm or interruptible available capacity for transportation on a firm transportation basis or on an interruptible transportation basis.

"(b) REQUIRED CARRIAGE.—

"(1) COVERAGE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), this section shall apply to any person engaged in natural gas transportation.

"(B) SPECIAL RULES.—This section shall not apply to any local distribution company, intrastate pipeline or field gathering system if the State commission having regulatory jurisdiction over such local distribution company, pipeline or system certifies to the Commission that (i) it has, and will exercise, the authority to require such local distribution company, pipeline or system (if it has available capacity) to transport natural gas without discrimination under terms and conditions comparable to those for transportation under this section, or (ii) that the local distribution company, intrastate pipeline or gathering system to which this section may otherwise apply has filed and in effect a tariff, rate schedule, or service agreement covering nondiscriminatory transportation service which is available without discrimination within the service area of the local distribution company, intrastate pipeline or gathering system.

"(C) EXTENT OF COMMISSION JURISDICTION.—A person shall not be subject to the jurisdiction of the Commission solely by reason of any transportation pursuant to this section except to the extent necessary to assure compliance with this section.

"(D) STATE AUTHORITY OVER CERTAIN TRANSPORTATION.—In the case of any person who requests service from an interstate pipeline under this section for a facility which, at any time in the immediately preceding 4 years, received gas from a local distribution company or from any person for which a service area has been determined under section 7(f) of the Natural Gas Act, the Commission shall not permit such interconnection or transportation unless—

"(I) the local distribution company involved contracts with the facility to transport or deliver the gas under terms and conditions approved by the State agency, or

"(II) the State agency having ratemaking jurisdiction over the area within which such facility is located gives its approval subject to such terms and with such conditions as the State agency may apply.

"(2) PROCESS.—

"(A) FILING REQUIREMENT.—The Commission shall require each pipeline to file a report every 6 months after the effective date of this section (or more frequently) describing capacity in the pipeline's facilities (indicating the geographic location and projected duration of such capacity) and current and anticipated transportation and such other information as the Commission finds appropriate to carry out this section. The Commission shall also require any person requesting transportation of natural gas under this section or any modification of any such transportation to file with the Commission such information regarding said request as may be necessary to implement this section. The Commission shall establish procedures under which material filed under this section shall be made available to affected persons, and to any State and local agencies having jurisdiction or authority. The Commission shall provide procedures and restrictions which protect the confidentiality of that information which the person requesting service or the pipeline demonstrates to the Commission is confidential or proprietary.

"(B) PROCEDURES.—

"(i) Any pipeline or distribution company which receives a request to transport natural gas under this section shall—

"(a) provide transportation as requested within 45 days of receiving such request, or

"(b) petition the Commission within 10 days for a determination that the pipeline or distribution company lacks available capacity to provide the transportation requested—

"(ii) in the event that a pipeline or distribution company petitions the Commission under paragraph (b)(i)(B), such pipeline or distribution company shall have the burden of demonstrating that it lacks the available capacity to provide the transportation requested; or.

"(iii) in the event that a pipeline or local distribution company provides transportation pursuant to paragraph (B)(i)(a), any interested party may petition the Commission for a determination that the pipeline or distribution company lacks the available capacity to provide the transportation requested. In the case of any such petition, the burden of demonstrating that the pipeline or distribution company lacks available capacity shall rest with the petitioner.

"(C) COMMISSION AUTHORITY.—The Commission shall establish public procedures to resolve any petitions filed under paragraph (B)(i)(b) and paragraph (b)(iii), and shall make a final determination with regard to any such petition within 45 days of the date on which the petition is filed. With request to such determination:

"(i) If the Commission determines that a pipeline or distribution company has available capacity to provide the transportation requested, it shall require said pipeline or distribution company to provide such transportation.

"(ii) The Commission shall, to the extent that available capacity is lacking, require a pipeline or distribution company to desist from the transportation of gas under this section if, based on a petitioner's demonstration, the Commission determines that the pipeline or distribution company does not have the available capacity pursuant to paragraph (3). The Commission shall have the authority to establish interim requirements for the transportation of natural gas pending final determination on any petition.

The rules issued by the Commission pursuant to this section shall be designed to discourage frivolous petitions under this section for determination by the Commission that a pipeline or distribution company lacks available capacity.

"(3) AVAILABLE CAPACITY.—For the purpose of carrying out this section, the Commission shall establish the methodology for determining whether available capacity exists to transport all or a portion of the natural gas requested on a firm transportation basis or on an interruptible transportation basis, as defined in paragraph (5). For the purpose of establishing such regulations:

"(A) Available capacity for transportation on a firm basis shall be considered to exist if it could be provided without impairing delivery of natural gas necessary to meet the maximum quantities applicable to each then existing customer for the receipt of natural gas under all rate schedules, tariffs, governmental licenses, or certificates in effect at the time of application to receive such service: *Provided, however,* That capacity in the pipeline shall be deemed available for transportation on a firm basis to a firm customer of a local distribution company to the extent that the State agency having ratemaking jurisdiction over the local distribution company authorizes such utilization. Such authorization may be for any number of days of the year and may be subject to interruption for use by the local distribution company. Nothing in this subsection shall affect the requirements of subsection (4).

"(B) Pending promulgation by the Commission of a rule pursuant to subparagraph (C), available capacity for transportation on an interruptible basis for any month shall be considered to be the greater of (i) the difference between the pipeline's total capacity and its average actual throughput over the previous 3 years, or (ii) the difference between the pipeline's total capacity and the reasonably forseeable requirements of its existing customers.

"(C) Within 12 months after date of enactment, the Commission shall issue a rule adopting or modifying the provisions of subsection (B). The rule shall achieve the objective of establishing an objectively verifiable standard, the objective of maintaining approximately the same average daily volumes of gas that were received prior to the date of enactment by existing customers purchasing under interruptible rate schedules, and the objective of this section to promote nondiscriminatory contract carriage.

"(4) ESSENTIAL AND HIGH PRIORITY USERS.—The Commission shall prescribe regulations which allocate capacity whenever a pipeline does not have sufficient available capacity to satisfy all of its obligations. Such regulations shall be prescribed and issued jointly with the regulations under paragraph (3), and shall provide that no customer shall be interrupted with respect to its entitlement to firm sales or firm transportation under any rate schedule, tariff, governmental license, or certificate until all interruptible requirements have been fully interrupted, and, in the event any curtailment of firm sales and transportation is necessary, such curtailment shall be on the basis of the priorities applicable under the Natural Gas Act (and title IV and this Act) for curtailment of deliveries. In determining the curtailments among interruptible customers, the Commission shall apply the priorities established under title IV of this Act for curtailment of deliveries. Such regulations shall not discriminate between the obligations arising under this subsection and other obligations.

"(5) DEFINITIONS.—For purposes of this section:

"(A) FIRM TRANSPORTATION BASIS.—The term 'firm transportation basis' means the ability, consistent with accepted engineering principles, to transport, store, and deliver a given volume of natural gas to a given location through all means, including direct haul, storage, compression, flow reversal, or transportation by displacement without interruption except in the case of force majeure.

"(B) INTERRUPTIBLE TRANSPORTATION BASIS.—The term 'interruptible transportation basis' means the ability, consistent with accepted engineering principles to transport, store, and deliver a given volume of natural gas to a given location through all means, including direct haul, storage compression, flow reversal, or transportation by displacement, subject to interruption on short notice to meet peak-load requirements or to meet the needs of firm- and high-priority users or due to circumstances of force majeure.

"(c) JUST AND REASONABLE RATES.—

"(1) IN GENERAL.—Except as provided in paragraph (2), any rates and charges of any pipeline or distribution company made with respect to any transportation provided pursuant to this section shall be just and reasonable (within the meaning of the Natural Gas Act) and shall recover the full cost of providing such services to the customer or customers receiving such services. Such rates and charges shall not discriminate between transportation under this section and any other transportation of gas including transportation of gas for sale or resale. No pipeline customer or distribution company customer shall be subject to a demand charge for the portion of its firm entitlement to receive gas which it uses to receive gas transported under this section unless such charge is levied on all customers receiving gas transported under this section.

"(2) REQUIREMENTS IF RATE IS LESS THAN MAXIMUM JUST AND REASONABLE RATE.—The Commission may not authorize any pipeline or distribution company to impose a rate or charge which is less than the maximum that would be just and reasonable unless

"(i) the pipeline or distribution company provides the same lower rate or charge for all classes of customers;

"(ii) the pipeline or distribution company is prohibited from recovering from any of its other customers any amount to compensate the pipeline or distribution company for revenue forgone by the pipeline or distribution company in offering such lower rate, and

"(iii) the rate is publicly filed as a tariff with the Commission.

"(3) ALLOCATION OF PREEXISTING TAKE-OR-PAY LIABILITIES.—To the extent that the Commission permits a pipeline to recover in rates any costs associated with prepayments (or any similar liability) for gas that was not taken prior to the date of enactment of this section (without regard to whether the costs were incurred before or after enactment), it shall allocate such costs to all transportation of gas including transportation under this subsection, and the transportation of gas for sale or resale.

"(d) OBLIGATION TO CONTINUE SERVICE.—Nothing in this section shall be construed to affect in anyway a pipeline's obligation at anytime to continue to render service under contracts and certificates then existing with local distribution companies and other customers. A then existing customer shall be entitled to use the maximum capacity it has available under all existing rate schedules, tariffs, Government licenses, contract, or certificates to receive gas purchases from the pipeline or to transport gas under this section or both. If a customer of an interstate pipeline elects to reduce its obligation to purchase natural gas from such pipeline, the obligation of such pipeline to sell natural gas to such customer pursuant to the Natural Gas Act shall be reduced to the extent, and such pipeline shall not be required to seek Commission approval of such reduction under section 7(b) of the Natural Gas Act.

"(e) MINIMUM BILL AND PIPELINE PURCHASE REDUCTION.—

"(1) Any minimum bill obligation existing on the date of enactment shall be reduced to the same extent that the customer's purchase from the pipeline has been reduced due to such customer's transportation of natural gas under this section.

"(2) REDUCTION IN PIPELINE PURCHASE OBLIGATION.—The interstate pipeline may elect to reduce its purchase obligations existing on the date of enactment from its suppliers by an amount necessary to offset any reduction in volume of natural gas sold by the pipeline from its system supply due to transportation under this section. In making any such reduction the pipeline shall reduce volumes ratably among all purchase contracts. This provision shall not be available as to any reduction in sales volumes due to transportation of gas produced by a production affiliate of the purchaser.

"(f) NONDISCRIMINATION PROVISION.—The Commission shall prohibit any pipeline or distribution company from discriminating in favor of or against any person under this section with respect to, but not limited to, any rate, charge, classification, rule, regulation, policy, practice, or service; further, service rendered by a pipeline or distribution company pursuant to this section shall not be conditioned upon the provision by the pipeline of any other service offered by the pipeline or distribution company.

"(g) BUYER'S COOPERATIVES.—The rules issued by the Commission pursuant to this section shall facilitate and encourage any local distribution company or municipality to cooperatively purchase gas. Nothing in this section shall be construed to prevent or impair formation of any buyer's cooperatives for the purchase and transportation of natural gas.

"(h) EXPEDITED PROCEEDINGS.—In carrying out subsections (a) and (b), the Commission shall, if appropriate, use expedited procedures.

"(i) VOLUNTARY TRANSPORTATION ALLOWANCE.—Any pipeline or local distribution company that voluntarily agrees to transport natural gas under this section shall be permitted to charge a nondiscriminatory incentive allowance (in excess of the just and reasonable rate, or the fair and equitable rate) for such transportation as established by the Commission.

"(j) TERMINATION.—The Commission may, by order, reduce or terminate the transportation service provided for under this section if the Commission determines that the service is not in accordance with this section.

"(k) RATE DESIGN.—Within 45 days of enactment of this section, the Commission shall initiate rulemaking procedures to establish a new interstate pipeline rate design that will encourage voluntary transportation of natural gas. The objectives of such rate design shall be as follows:

"(1) to establish incentives that encourage pipelines to provide adequate transmission services at minimum cost;

"(2) to make pipelines indifferent between selling their own system supply and providing transportation for others;

"(3) to ensure clear and prompt transmission of price signals in both directions between the wellhead and burnertip markets; and

"(4) to allocate risk to those who have chosen to bear it in exchange for the opportunity to earn profits.".

(b) STATE RATEMAKING AUTHORITY.—Section 602 of the Natural Gas Policy Act of 1978 is amended by adding new subsection (c) to read as follows:

"(c) STATE REGULATORY AUTHORITY.—(1) Nothing in this Act, or in the Natural Gas Act, shall preclude any State regulatory authority, acting pursuant to State law, from reviewing the natural gas purchasing practices or from disallowing the natural gas purchase costs of any utility subject to its jurisdiction in accordance with State law.

"(2) Nothing in this section shall authorize any State agency to establish maximum lawful prices for the first sale of natural gas. A State agency shall not have authority under this section to establish, by rule, order, or statement of policy, a presumption respecting the level of natural gas purchase price from producers or pipelines at or above which payment by a local distribution company is presumed imprudent or at or below which payment by a local distribution company is presumed prudent.".

(c) MONITORING AND REPORTING REQUIREMENTS.—

(1) MONITORING.—The Federal Regulatory Commission shall monitor and gather data concerning transactions carried out pursuant to section 316 of the Natural Gas Policy Act of 1978, including volumes of natural gas transported, problems concerning available capacity, costs and reliability of service of the pipelines

transporting natural gas, protection of the capacity required by then existing customers of the pipeline, and the impact of such transportation on other users or customers of the pipelines.

(2) REPORT.—The Commission shall, after evaluating such data and consulting with appropriate State regulatory authorities and other persons, prepare and submit a report to the Congress within twenty-four months after the date of the enactment of this Act. Such report shall include an evaluation of the implementation of the authority provided in section 230(b) of the Natural Gas Policy Act of 1978, recommendations (if any) for modifications of such authority, and an analysis of whether requiring interstate pipelines to operate as common carriers would be in the public interest.

(d) COORDINATION WITH THE NATURAL GAS ACT.—All transportation of natural gas shall be provided under section 316 of the Natural Gas Policy Act and that section shall supersede all other authorities previously enacted which authorize transportation of natural gas.

99TH CONGRESS
1ST SESSION

S. 1251

Entitled the "Natural Gas Utilization Act of 1985".

IN THE SENATE OF THE UNITED STATES

JUNE 6 (legislative day, JUNE 3), 1985

Mr. DOMENICI (for himself and Mr. JOHNSTON) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

Entitled the "Natural Gas Utilization Act of 1985".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. (a) SHORT TITLE.—This Act may be cited as the "Natural Gas Utilization Act of 1985".

(b) TABLE OF CONTENTS.—

TABLE OF CONTENTS

Sec. 1. Short title; table of contents.
Sec. 101. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 102. Conforming amendments.
Sec. 103. Repeal of incremental pricing requirements.
Sec. 104. Effective date.

REPEAL OF CERTAIN SECTIONS OF THE POWERPLANT AND INDUSTRIAL FUEL USE ACT OF 1978

SEC. 101. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed:

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29)—(42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

CONFORMING AMENDMENTS

SEC. 102. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "And Exemptions";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit";

(5) in subsection (d)(1)(B), "or in the consideration of such petition,";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "Or Exemption";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or a major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

REPEAL OF INCREMENTAL PRICING REQUIREMENTS

SEC. 103: (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flowthrough of costs incurred before the enactment of this section, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

EFFECTIVE DATE

SEC. 104. The provisions of this Act shall take effect on the date of enactment.

99TH CONGRESS
1ST SESSION

S. 1302

To amend the Natural Gas Policy Act of 1978, to protect consumers from market distortions that occur as a consequence of current partial regulation of natural gas prices by eliminating the remaining wellhead price regulation as contracts expire, or terminate, or are renegotiated, to permit natural gas contracts to reflect free market prices, to eliminate incremental pricing requirements for natural gas, to eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 13 (legislative day, JUNE 3), 1985

Mr. NICKLES introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Natural Gas Policy Act of 1978, to protect consumers from market distortions that occur as a consequence of current partial regulation of natural gas prices by eliminating the remaining wellhead price regulation as contracts expire, or terminate, or are renegotiated, to permit natural gas contracts to reflect free market prices, to eliminate incremental pricing requirements for natural gas, to eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE; TABLE OF CONTENTS

SECTION 1. SHORT TITLE.—This act may be cited as the "Natural Gas Regulatory Reform Act of 1985".

TABLE OF CONTENTS

Sec. 1. Short title, table of contents.

TITLE I—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN FIRST SALES

Sec. 101. Removal of wellhead price controls.
Sec. 102. Repeal of Natural Gas Act jurisdiction over certain sales of committed or dedicated natural gas.
Sec. 103. Repeal of provisions allowing reimposition of price controls and report to the Congress.

TITLE II—REPEAL OF CERTAIN RESTRICTIONS OF NATURAL GAS AND PETROLEUM USE

Sec. 201. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 202. Amendment of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.

TITLE III—REPEAL OF INCREMENTAL PRICING REQUIREMENTS

Sec. 301. Repeal of incremental pricing requirements.

TITLE IV—SEPARABILITY

Sec. 401. Separability.

TITLE I—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN FIRST SALES OF NATURAL GAS

REMOVAL OF WELLHEAD PRICE CONTROLS

SEC. 101. Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by the deletion of the words "Subject to the reimposition of price controls as provided in section 122, the" and inserting in lieu thereof

"The", and by the addition of a new subsection (f) to read as follows:

"(f) SPECIAL RULE.—The provisions of subtitle A shall not apply to—

"(1) gas subject to any contract for the first sale of natural gas that was executed after the date of enactment of this subsection,

"(2) gas subject to any contract for the first sale of natural gas that was renegotiated after the date of enactment of this subsection is such renegotiated contract expressly provides that the provisions of subtitle A shall not apply,

"(3) gas subject to any contract for the first sale of natural gas that will expire, lapse, or terminate pursuant to its own terms after the date of enactment of this subsection at such time as that contract expires, lapses, or terminates pursuant to its own terms,

"(4) gas subject to any contract for the first sale of natural gas that expired, lapsed, or terminated pursuant to its own terms, or

"(5) gas subject to any contract for the first sale of natural gas which does not expire by its own terms and which contains a renegotiation provision, or which is a successor to a contract which contained a renegotiation provision, shall be deemed eligible for renegotiation pursuant to such provision, and any otherwise applicable limitation of the Natural Gas Act or this Act shall not apply.".

REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN SALES OF COMMITTED OR DEDICATED NATURAL GAS

SEC. 102. Section 601(a)(1)(B) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(B)) is amended by striking "or" at the end of clause (ii), by replacing the period at the end of clause (iii) with a semicolon, and by the addition of a new clause (iv) to read as follows:

"(iv) natural gas exempted from the operation of subtitle A of title I pursuant to section 121(f).".

REPEAL OF PROVISIONS ALLOWING REIMPOSITION OF PRICE CONTROLS AND REPORT TO THE CONGRESS

SEC. 103. (a) Sections 122 and 507 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3332 and 3417) are repealed.

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by striking the items relating to sections 122 and 507.

TITLE II—REPEAL OF CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM

SEC. 201. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed—

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

SEC. 202. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(B), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

TITLE III—REPEAL OF INCREMENTAL PRICING REQUIREMENTS

SEC. 301. (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flow-through of costs incurred before the enactment of this section, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

TITLE IV—SEPERABILITY

Sec. 401. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the applicability of any other provison to any other person or circumstance shall not be affected.

99TH CONGRESS
2D SESSION

S. 2205

To eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 18, 1986

Mr. NICKLES (for himself and Mr. BOREN) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE; TABLE OF CONTENTS

SECTION 1. SHORT TITLE.—This Act may be cited as the "Fuel Use Act Repeal Bill of 1986".

TABLE OF CONTENTS

TITLE I—REPEAL OF CERTAIN RESTRICTIONS OF NATURAL GAS AND PETROLEUM USE

Sec. 101. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 102. Amendment of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.

TITLE II—SEPARABILITY

Sec. 201. Separability.

TITLE I—REPEAL OF CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM

SEC. 101. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed—

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

SEC. 202. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(P), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing of new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

TITLE II—SEPARABILITY

SEC. 201. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the applicability of any other provision to any other person or circumstance shall not be affected.

99TH CONGRESS
2D SESSION

S. 2285

To promote competition in the natural gas market, to ensure open access to transportation service, to encourage production of natural gas, to provide natural gas consumers with adequate supplies at reasonable prices, to eliminate demand restraints, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 10 (legislative day, April 8), 1986

Mr. MCCLURE (by request) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To promote competition in the natural gas market, to ensure open access to transportation service, to encourage production of natural gas, to provide natural gas consumers with adequate supplies at reasonable prices, to eliminate demand restraints, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Natural Gas Policy Act Amendments of 1986".

TABLE OF CONTENTS

TITLE I—OPEN ACCESS TO TRANSPORTATION

Sec. 101. Nondiscriminatory authorizations.
Sec. 102. Open access carriage.

TITLE II—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF JURISDICTION OVER FIRST SALES

Sec. 201. Removal of wellhead price controls.
Sec. 202. Repeal of Commission jurisdiction over first sales of natural gas.
Sec. 203. Effect of area rate clauses.

TITLE III—REPEAL OF CERTAIN RESTRICTIONS ON NATURAL GAS AND PETROLEUM USE AND PRICING

Sec. 301. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 302. Conforming amendments.
Sec. 303. Repeal of incremental pricing requirements.

TITLE I—OPEN ACCESS TO TRANSPORTATION

NONDISCRIMINATORY AUTHORIZATIONS

SEC. 101. Section 311(a) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3371(a)) is amended by—

(a) revising paragraph (1) to read as follows:

"(1) IN GENERAL.—The Commission, by rule or order, may authorize any pipeline to transport natural gas on behalf of any person.".

(b) redesignating subparagraph (1)(B) as paragraph (2);

(c) deleting subparagraph (2)(A);

(d) redesignating subparagraphs (2)(B)(i), (2)(B)(ii), (2)(B)(ii)(I), and (2)(B)(ii)(II) as subparagraphs (3)(A), (3)(B), (3)(B)(i), and (3)(B)(ii), respectively.

(e) adding a new paragraph (4) to read as follows:

"(4) NONDISCRIMINATION.—

"(A) A pipeline transporting gas pursuant to this subsection shall do so without discrimination.

"(B) A pipeline receiving gas pursuant to this subsection shall provide transportation service pursuant to this subsection without discrimination.".

OPEN ACCESS CARRIAGE

SEC. 102. (a) Title III of the Natural Gas Policy Act of 1978 (15 U.S.C. 3361–3375) is amended by adding the following new section:

"SEC. 316. OPEN ACESS CARRIAGE.

"Upon request by any person, the Commission shall direct an interstate pipeline to provide transportation service, unless the pipeline demonstrates to the Commission it is incapable of rendering the service. The pipeline shall provide this transportation service without discrimination. The rates and charges for this transportation service shall be just and reasonable within the meaning of the Natural Gas Act. The Commission may implement this section by rule or order, and may attach appropriate terms and conditions consistent with the fullest practicable use of capacity.".

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by adding after the item relating to section 315 the following:

"Sec. 316. Open access carriage.".

TITLE II—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF JURISDICTION OVER FIRST SALES

REMOVAL OF WELLHEAD PRICE CONTROLS

SEC. 201. Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by adding at its end the following new subsections:

"(f) SPECIAL RULE FOR CERTAIN GAS.—The provisions of subtitle A shall not apply to—

"(1) gas subject to any contract for the first sale of natural gas executed after March 1, 1986, or

"(2) gas subject to any contract for the first sale of natural gas renegotiated after March 1, 1986, if the renegotiated contract expressly provides the provisions of subtitle A shall not apply.

"(g) REMOVAL OF WELLHEAD PRICE CONTROLS ON NATURAL GAS.—Beginning April 1, 1987, the provisions of subtitle A respecting maximum lawful price shall cease to apply to the first sale of any natural gas.".

REPEAL OF COMMISSION JURISDICTION OVER FIRST SALES OF NATURAL GAS

SEC. 202. (a) Section 601(a)(1)(B) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(B)) is revised to read as follows:

"(B) COMMITTED OR DEDICATED NATURAL GAS.—For purposes of section 1(b) of the Natural

Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was committed or dedicated to interstate commerce as of the day before the date of enactment of this Act solely by reason of any first sale of such natural gas.".

(b) Section 315 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3375) is repealed, and the item relating to section 315 is stricken from the table of contents of that Act.

EFFECT OF AREA RATE CLAUSES

SEC. 203. (a) Title III of the Natural Gas Policy Act of 1978 (15 U.S.C. 3361–3375) is amended by adding the following new section:

"SEC. 315. EFFECT OF AREA RATE CLAUSES.—With respect to gas that would be subject to a maximum lawful price under section 104 or 106(a) of this Act except for section 121(g), the last price paid for the gas while it was subject to a maximum lawful price under section 104 or 106(a) shall be considered a federally established rate or price for purposes of an area rate clause. This section shall apply only to a contract that has no indefinite price escalator clause, other than an area rate clause, and that was executed at a time when the inclusion of any indefinite price escalator clause other than an area rate clause was proscribed by Federal regulation.".

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by adding after the item relating to section 314 the following:

"Sec. 315. Effect of Area Rate Clauses.".

TITLE III—REPEAL OF CERTAIN RESTRICTIONS ON NATURAL GAS AND PETROLEUM USE AND PRICING

REPEAL OF CERTAIN SECTIONS OF THE POWERPLANT AND INDUSTRIAL FUEL USE ACT OF 1978

SEC. 301. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed:

(1) sections 103(a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302(a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents in section 101(b) of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301(b)) is amended by striking the items relating to the sections repealed by subsection (a) of this section.

CONFORMING AMENDMENTS

SEC. 302. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows: "The provisions of this Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States."

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(B), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated) ", or by the denial of a petition for an

order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

REPEAL OF INCREMENTAL PRICING REQUIREMENTS

SEC. 303. (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flowthrough of costs incurred before the enactment of the Natural Gas Policy Act Amendments of 1986, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

STATEMENT OF HON. CHIC HECHT, A U.S. SENATOR FROM THE STATE OF NEVADA

Senator Hecht. Thank you, Mr. Chairman.

In recent weeks this committee has held hearings on the impact of the recent drastic decrease in the price of oil on the domestic oil gas industry. I for one am concerned about what impact this decrease will have on our domestic industry and ultimately on national security.

History tells us that these low prices are temporary swings in the supply and demand equation for oil and gas. My aim is to help correct the current low price without saddling industry with artificial controls and supports. To accomplish this, I have been reviewing both regulatory and legislative approaches.

Before the Easter recess I requested Secretary Hodel to review the BLM regulatory and administrative actions in regard to production from existing wells on Federal lands to determine if these actions could be adjusted to encourage continued production or at least allow shut-in resident abandonment of wells.

Recently I was encouraged with his announcement that the BLM has agreed to grant our application for a suspension of production for Federal leases with stripper wells. His office has also showed me that they are looking to similar relaxation for marginal wells on Federal lands.

In addition to regulatory relief, recently I joined Senator Domenici as a cosponsor of his bill, S. 1251, which would repeal the Fuel Use Act. I am also a cosponsor of S. 2206, which would repeal the windfall profits tax.

Mr. Chairman, I appreciate this opportunity to hear from the administration and industry on the various proposals for gas deregulation.

Thank you.

Senator Nickles. Senator Hecht, thank you very much. I also appreciate your cosponsoring our bill to repeal the windfall profits tax. Hopefully we will be able to do that as soon as possible as well.

I also have a statement by Senator McClure which we will have entered into the record at this point.

[The prepared statement of Senator McClure follows:]

STATEMENT OF
THE
HONORABLE JAMES A. McCLURE
CHAIRMAN
COMMITTEE ON ENERGY AND NATURAL RESOURCES

AT THE COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARING ON

PENDING NATURAL GAS LEGISLATION:
S. 834, S. 1251, S. 1302, S. 2205, S. 2285

May 20, 1986

Good morning. This is a legislative hearing on the five natural gas bills that are now pending before this Committee. The purpose of this hearing is to elicit additional information that will assist in expediting Committee consideration of comprehensive natural gas legislation--legislation that would, in my opinion, materially benefit consumers, producers and the Nation.

Comprehensive legislation must include three main elements: deregulation of the remaining regulated natural gas; elimination of fuel use restrictions; and provisions for mandatory natural gas transportation. The net effect of comprehensive legislation would be to assure this Nation's natural gas consumers an abundant and reliable long-term supply of natural gas at the lowest possible price.

Eight years ago Congress enacted the Natural Gas Policy Act of 1978. It was designed to provide incentives to stimulate natural gas exploration and development, incentives which were lacking in prior federal regulation. As successful as it has been in stimulating natural gas production, the NGPA was but a half step; Congress was then not certain that the marketplace could or would work for natural gas. Out of fear of massive price increases if all gas were deregulated, the NGPA provided only for the deregulation of about half of our natural gas supply.

However, the evidence amassed to date clearly and convincingly proves that deregulation does not increase the price of natural gas, and that regulation artifically holds the price of gas at above-market levels. On January 1, 1985, the NGPA deregulated half of flowing natural gas. Rather than increase the wellhead price and the price consumers pay for natural gas, the deregulation which took place in 1985 has instead fostered increased competition and lower gas prices. Department of Energy data shows an 11 percent decline in the average wellhead price of natural gas during 1985, and further price declines have taken place during 1986.

Moreover, at the Subcommittee on Energy Regulation and Conservation's April 15, 1986, hearing, evidence was presented which conclusively proves that federal price regulations artifically prop up the price of natural gas. Department of Energy data presented showed that NGPA Section 102 deregulated gas sells for less than Section 102 regulated gas. How could that occur unless federal price controls are now acting as floors instead of ceilings?

It is also time to eliminate the artificial restrictions on fuel use contained in the Powerplant and Industrial Fuel Use Act of 1978 and to repeal the incremental pricing provisions of the NGPA. These restrictions were predicated on the now disproven theory that domestic oil and gas supplies are running out. Clearly, they are not.

And finally, it is now time for the Congress to provide the statutory authority necessary to ensure that producers and consumers have open access to this Nation's natural gas transmission system. Although the Federal Energy Regulatory Commission is making a good effort in opening up that system, the Commission is hindered in its efforts by a lack of statutory authority. An open transportation system would encourage greater competition amoung buyers of natural gas, and among sellers of gas. Buyers could seek out lower-priced supplies; sellers would benefit by an opportunity to increase sales through production of gas that is currently shut-in and through access to new markets.

The Department of Energy has concluded that comprehensive natural gas legislation would reduce the price of natural gas, increase domestic production, result in the production of gas reserves that would otherwise be shut-in and lost forever, and be of overall benefit to this Nation's economy. That was recently confirmed in an independent analysis by the Department's Energy Information Administration.

It is now time to move forward and eliminate the remaining vestiges of unwarranted federal natural gas regulation and to provide for fair and equitable access to this Nation's natural gas transportation system.

Senator **Nickles**. Mr. Secretary, we welcome you again before this committee. We appreciate your assistance and also the work that you have done in fighting for natural gas decontrol.

Do you have an opening comment you wish to make?

STATEMENT OF HON. JOHN S. HERRINGTON, SECRETARY, DEPARTMENT OF ENERGY, ACCOMPANIED BY STEPHEN T. MINIHAN, ACTING DIRECTOR, ECONOMIC ANALYSIS

Secretary **Herrington**. Yes, Mr. Chairman. Thank you.

I do not know if this microphone is on or not. Can you hear me?

Senator **Nickles**. Yes.

Secretary **Herrington**. OK. With the committee's permission, I would like this statement to be put in the record, but I do have a few comments.

Now is the best time for natural gas legislation. That is the hypothesis that I put before you this morning. The recent decline in oil prices has increased the need to remove what I think are counterproductive barriers to full development and use of all of our domestic energy resources. Lower oil prices are discouraging development of domestic oil supplies, and they have hurt the economies of many of our energy-producing States. I do not think we would argue with that statement.

Increased production and the use of natural gas will replace some lost supplies, stimulate the economies of both the energy-producing and the energy-consuming States, and increase our energy security. In short, comprehensive deregulation will stimulate the natural gas industry. And this will increase production and will create jobs. It also promotes our national security because it will reduce reliance on imported oil, and that is something we need to continue to work on.

There does not appear to be any justification existing today for continuing to withhold the benefits of comprehensive deregulation from the American people. We know that deregulation works. How? Oil decontrol. We lowered prices. We increased production. Partial decontrol of natural gas. We have proof as we sit here today of reduced prices, and we proved to all those people that said prices would go up that they were wrong.

And finally, this morning we have by analogy a new Energy Information Administration [EIA] report on the old gas rule that indicates that deregulation leads to lower prices and increased production. We have those charts with us this morning. Comprehensive deregulation is needed now, and there is no point in withholding its benefits any longer. I do not know of one single reason why we should walk away from this important issue at this time.

What type of legislation? The legislation must be comprehensive. Only comprehensive legislation can remove the barriers to full competition and can ensure that domestic gas sources are fully developed and made available to all natural gas consumers. Let us take three provisions. First, prices. Wellhead price controls shut in our lowest cost supplies and they keep prices artificially high. We estimate through studies and work at the Department of Energy and at EIA that decontrol will add 30 to 34 trillion cubic feet of old gas otherwise lost under our current regulations.

This big supply increase will lower gas costs and will provide lower prices, and our new EIA report agrees. It concludes, No. 1, that DOE's proposed old gas pricing rule will free production of 28 trillion cubic feet of old gas. The report also concludes that prices in high-cost contracts are responsive to market pressures and have been renegotiated downward due to competition.

The second point, transportation. Lack of access to transportation also prevents low-cost gas from getting to the marketplace, and without access consumers are losing the freedom to choose the least costly source of supply. Producers without access cannot compete with other producers by offering lower prices, and our new EIA report shows that access is vital. The report says that DOE's old gas rule and broad use of FERC order 436 would lower prices to consumers because wellhead prices would drop approximately 35 cents an MCF.

The third point, demand restraints. We have heard a lot in the past few weeks about a stand-alone Fuel Use Act repeal without a comprehensive bill. Demand and use restraints have potential to prevent gas from competing with other fuels on the basis of price. We know that. This could cause inefficient, high-cost fuel choices, but repeal of the Fuel Use Act by itself cannot solve the problems, as worthy as that cause is. Exemptions to the Fuel Use Act prohibitions have never been denied. Exemption requests are substantial. There were 104 exemptions granted last year, and more this year. Repeal of the Fuel Use Act does not eliminate the real barriers to lower prices and increased production. Without a comprehensive solution, the anticipated benefits of repealing the Fuel Use Act alone are illusory.

Only comprehensive deregulation eliminates these barriers which keep prices too high and shut in our cheapest supplies.

The final point is this. It is something that we all suspect. Everyone benefits from comprehensive legislation. Comprehensive legislation will provide major benefits to the consumers, to the industry, and to the country. Consumers will save on their gas bills between $25 to $45 in the first year after decontrol. Significant increases in gas supply will help keep prices down. Thirty to thirty-four trillion cubic feet of old gas will be produced under a comprehensive deregulation scenario.

Average annual consumption will go up 750 to 850 billion cubic feet on average each year from 1987 to 1995. And finally, reliance on foreign oil would drop 300,000 to 350,000 barrels a day between 1987 and 1995. This alone, this last point, will save between $1.4 to $3.8 billion on U.S. balance of payments on average per year. Savings on gas imports would be $3 to $5 billion from 1987 to 1995. The economy would realize net benefits totaling between $16 to $24 billion, depending on oil prices, between 1987 and 1995, but legislation must be comprehensive in order to realize these benefits.

Comprehensive deregulation promises enormous benefits. We have the opportunity to fulfill this promise if we have the courage to strike down the real barriers that stand in the way of a free and responsive natural gas market, Mr. Chairman. Thank you for letting me give my comments this morning.

[The prepared statement of Secretary Herrington follows:]

STATEMENT

BY

JOHN S. HERRINGTON

SECRETARY OF ENERGY

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

MAY 20, 1986

Mr. Chairman, Members of the Committee, I appreciate the opportunity to appear before you today to discuss natural gas legislation. It is particularly encouraging to see this Committee and its House counterpart focusing on natural gas legislation. This effort is vital to a strong and secure energy future for America, and it is my hope that this Committee will continue to take steps toward a free natural gas market in 1986.

COMPREHENSIVE LEGISLATION IS NEEDED NOW

Now is the best time for natural gas deregulation legislation. The recent decline in oil prices provides a unique opportunity to remove counterproductive barriers to the full development and use of all of our domestic energy resources. Lower oil prices are placing downward pressure on prices of all energy sources and creating excess supplies of both oil and natural gas. Deregulation at this time will cause minimal disruption to the market, to producers or to consumers. Increased production and use of natural gas under comprehensive legislation will also stimulate the economies of both producing and consuming states, and increase our energy security.

Comprehensive legislation will stimulate the natural gas industry, resulting in increased gas production and the creation of new jobs. Under current regulations, gas production is constrained, gas transportation is not economically efficient, and less gas is sold than can be brought to market. The elimination of counterproductive regulatory barriers will mean more production, more demand for transportation, and more sales of natural gas. In short, deregulation will mean increased economic activity, which will benefit all segments of the natural gas industry, all natural gas consumers, and all the industries that serve the natural gas market.

The benefits of natural gas deregulation go beyond increased economic activity. Natural gas is also an important component of our energy security. Comprehensive legislation will promote energy security by reducing our reliance on potentially insecure foreign oil supplies and allowing natural gas to play an even greater role in ensuring that American consumers receive adequate supplies of domestically produced energy. This is especially important in light of the recent fall in world oil prices.

The time to enact legislation is now. We know that deregulation works. There is no justification for continuing to withhold the benefits of comprehensive deregulation from the American people. The benefits of competition that have resulted from energy deregulation are clear.

- -- Full decontrol of oil has led to lower prices and increased domestic production.

- -- Partial decontrol of natural gas has reduced prices and proven that natural gas will respond to market forces. Claims to the contrary by those who predicted a "fly-up" in gas prices were wrong.

The most recent evidence of the benefits of deregulation is offered by the analysis issued last week from the Energy Information Administration (EIA). EIA found that increased market pressures from partial decontrol and lower oil prices have led to renegotiation of prices across all NGPA sections and in all vintages of new and high-cost contracts. Natural gas prices have declined because pipeline companies and producers have been working out contract problems in response to increased market pressures. These findings show that competitive market forces cannot be ignored. Comprehensive deregulation will increase the competitive market forces brought to bear on high-priced contracts and create irresistable pressures to lower prices to competitive market levels.

The success of free market principles has been amply demonstrated. Moreover, legislation to release the full potential of a free and fully competitive gas market is long overdue.

LEGISLATION MUST BE COMPREHENSIVE

The full benefits of a free gas market will result only from comprehensive legislation which will ensure that domestic gas resources are fully developed and made available to all natural gas consumers. The Administration has proposed legislation that addresses all key elements including prices, access to transportation, and demand restraints in order to remove all barriers to a fully competitive natural gas market.

Prices. Current price controls prevent production of our lowest cost gas supplies and keep prices artificially high. By removing price controls, DOE estimates that comprehensive legislation would add 30 to 34 trillion cubic feet of old gas that otherwise will be lost under current regulations. EIA's recent analysis indicates that about 28 trillion cubic feet of additional old gas supplies would be produced if old gas were allowed to receive market prices. Studies by both agencies show that comprehensive legislation would result in lower cost gas production and lower natural gas prices, and that increased gas production and consumption will occur in every year following deregulation.

Transportation. Lack of access to transportation prevents low-cost gas from getting to the marketplace. Under current regulations, many consumers are unable to freely choose the least expensive source of supplies. Producers with low-cost supplies are prevented from competing with other suppliers by offering lower prices.

Open access to transportation would increase competition among pipelines to offer the least costly transportation services. In addition, producers and consumers would pressure pipelines to reduce transportation costs to ensure the best possible price for gas. By opening access to transportation, comprehensive legislation will further encourage competition in the natural gas market, thus leading to lower prices and increased sales.

Demand Restraints. Demand restraints as embodied in the Fuel Use Act (FUA) and incremental pricing provisions of the Natural Gas Policy Act (NGPA) add to the cost of using gas and prevent gas from competing effectively with other fuels. This encourages inefficient, higher cost fuel choices and discourages the full use of our domestic gas resources.

We have tried to minimize the inefficiencies created by the FUA through a streamlined process of granting exemptions to the Act's prohibitions. Indeed, the number of requests for exemptions is substantial--104 exemptions were granted last year; even more will be granted this year. These numbers are clear evidence of the potential burdens on natural gas users created by the FUA.

But removing the burdens of the FUA will not alone redress the regulatory inadequacies of current controls on natural gas. Without comprehensive legislation to address prices and access to transportation, the anticipated benefits of repealing FUA will be illusory.

Comprehensive legislation eliminates all of these barriers to competition and allows the full production, transportation, and use of our least costly domestic natural gas resources.

EVERYONE BENEFITS FROM COMPREHENSIVE LEGISLATION

Comprehensive deregulation promises major benefits for consumers, industry, and the Nation.

-- Consumers would save $25 to $45 on their gas bills in the first year after decontrol.

-- Industry would produce, transport, and sell 750 to 850 billion cubic feet more gas on average each year from 1987 to 1995.

-- Reliance on foreign oil would drop by 300 to 350 thousand barrels per day on average between 1987 and 1995.

- -- Reduced payments for oil imports would save $1.4 billion to $3.8 billion per year on the U.S. balance of payments.

- -- Savings on gas imports would be $3 billion to $5 billion from 1987 to 1995.

- -- The economy would realize net benefits totalling $16 billion to $24 billion from 1987 to 1995.

These benefits will only be realized by enacting comprehensive legislation and removing the regulatory burdens that stifle production and transportation of our lowest cost gas supplies.

CONCLUSION

Mr. Chairman, this Committee can strike a major blow for consumers, the natural gas industry, and the economy this year by enacting natural gas reform. But if consumers, industry and the country are to really achieve the benefits of gas legislation, it is imperative that the solution be comprehensive. Only comprehensive deregulation promises substantial benefits. We have the opportunity to fulfill this promise. What we need now is determination by the Congress to see this goal to its end and the courage to strike down the real barriers that stand in the way of a free and responsive natural gas market.

Senator **Nickles**. Mr. Secretary, thank you very much. Were you wanting to show us something on your charts?

Secretary **Herrington**. I would, Mr. Chairman, and I would like to introduce Steve Minihan. The charts are hard to see in the room, so I will ask him to move them back a little bit so that you can see, possibly at least half of the audience can see them. What they address are gas prices in the NGPA section 102, 103, and 107 categories, and this is based on a new EIA report.

Steve, if you would explain the charts you are showing to the chairman.

Mr. **Minihan**. This is the "new" gas price, the section 102 price. These were findings from the EIA natural gas report that just came out to review the supply response associated with our old gas pricing rule. The interesting evidence—this is actually data collected from PGA's filed at FERC—is that gas prices for different contracts signed in different periods of time have all declined for new gas. There has been a lot of speculation, or there was prior to partial decontrol and along with complete decontrol, that some gas prices would not decline, especially those gas prices in contracts that were signed prior to the drop in oil prices that started in 1981 and prior to partial decontrol.

What we can see is contracts signed in the 1978 to 1981 period have in fact started coming down, and of course contracts that were signed more recently after the declining oil prices have come down more quickly than those other contracts, but nonetheless all contracts have come down in price. These are section 102 new gas prices. The next chart shows the section 107 high-cost gas prices, and they at one point reached as high as almost $8 a thousand cubic feet, because some of this gas was decontrolled. In fact, the gas prices in this category have declined much more quickly than in other categories of gas, but again the same tendency is apparent, the contracts signed before the drop in oil prices have come down, although they didn't start as fast as the other contracts that were signed with more flexible contract terms prior to the drop in oil prices.

The final chart is the section 103 prices of gas from new production wells on existing fields, but again, we have the same general tendency down. Even the old contracts signed in a period when the prices were much higher have come down, and this is even a bit more intriguing, because some of the section 103 gas has not been decontrolled yet. Some of the section 103 gas in fact remains under price control. Those wells that are drilled, infill wells that are drilled on fields that are dedicated to interstate commerce before the NGPA was passed, and some of the 103 wells that are not as deep as 5,000 feet will not be decontrolled until 1987.

Senator **Nickles**. Thank you very much. I will just make a general comment on your charts. I have not thoroughly reviewed the EIA study, but those prices are a lot lower in the field today than what any of the prices that you are showing on any of those categories, 102's, 103's, or 107's. All the prices in the field today are much, much lower than what that chart has indicated.

Mr. **Minihan**. These are spot prices for some of that gas that is sold at whatever willing purchasers and sellers can agree on would be much lower than this, and we have seen prices, and I am sure you have, down to close to $1.40 per MCF.

Senator NICKLES. A dollar forty is commonplace, and there are a lot of contracts a lot less than that, and a lot of your contracts are showing still average prices for something in the one you have up for 103, which is still under—part of 103 is under price controls. Is that correct?

Mr. MINIHAN. Yes. Two parts of 103 are still under price controls.

Senator NICKLES. Which parts?

Mr. MINIHAN. The wells shallower than 5,000 feet remain under price controls until 1987, and wells that are dedicated to interstate commerce remain under price controls forever.

Senator NICKLES. And those have actually decreased as well, those contracts?

Mr. MINIHAN. Yes, exactly.

Senator NICKLES. So there has been some renegotiated contracts, or at least those contracts are falling away from the maximum allowed under NGPA.

Mr. MINIHAN. Absolutely.

Senator NICKLES. OK. A couple of questions. Mr. Secretary, you mentioned your hope and desire for a more comprehensive approach than just the Fuel Use Act repeal. I agree with that. You also mentioned, and I hope that we can do more. I also would tell you the same thing I mentioned before when you were before us, that if that is all we can get, I want to get that much. We need to send some kind of good signals, and anything we can do is better than nothing, so I hope that we can eliminate end-use restraints, but I hope, like you, I hope that we can do more.

Now, one question, you mentioned concerning the Fuel Use Act, you mentioned that all exemptions requested have been granted, and I think you said 104 last year.

Secretary HERRINGTON. Yes, sir.

Senator NICKLES. What kind of time period, if a person or an organization in an industrial plant or whatever requested an exemption from the Fuel Use Act, how long does it take to have that exemption granted?

Secretary HERRINGTON. We figure an average of 76 days.

Senator NICKLES. So 2 or 3 months?

Secretary HERRINGTON. Yes.

Senator NICKLES. Of course, it takes some time to prepare that and get it to your office. Do you have any idea what the average cost might be in making that exemption request?

Secretary HERRINGTON. I do not. We could attempt to estimate it and submit it to the record if the chairman would like.

Senator NICKLES. If you would.

[The information referred to follows:]

As stated previously, the exact cost of preparing the average petition is not available. Estimating the costs are difficult due to variance of costs related to the type of exemption, complexity of the design of the facility, and environmental considerations. In addition much of the required data, particularly environmental data, is also needed for permitting procedures at the state and local levels. These costs would have to be incurred in the absence of the Fuel Use Act. Where petitioners have requested DOE's assistance, as many have significnt cost savings have been achieved by reducing unnecessary paperwork and duplicate efforts.

DOE contacted a petitioner that has prepared several of the more difficult petitions for exemptions, and found that an average of 120 clerical hours and 280 professional man-hours were required to prepare the petition. If an average man-hour cost of $50 was used it would result in a cost of $20,000. An uninformed petitioner may experience a higher cost by providing more detail than is needed. For example, peakload exemptions require only a brief description of the powerplant, a certification that the facility will be used for peakload purposes only, and a environmental checklist, about 30 pages total. These abbreviated petitions could cost only a few hundred dollars. Recently, rules have been revised to simplify and reduce paperwork for cogeneration petitions, the largest category of exemption petitions received in 1985 and 1986. This change should result in costs to petitioners similar to that of peakload exemptions and DOE is studying additional changes to reduce both the time and cost in the processing of these petitions for exemption.

Senator **Nickles**. For the exemption you grant, let us say you are an industrial plant, and you want an exemption, or you are a utility and you want to build a new plant or something. How long do you grant them an exemption for the life of the plant?

Secretary **Herrington**. Mr. Chairman, I would like to submit that answer rather than guess at it.

Senator **Nickles**. I would appreciate that. Again, if the exemption is short term, and you are talking about utilities, that is of very marginal value, because the utility would be looking at the significant investment. Likewise in industrial plants if they are looking at building capacity or capability or something, you could be talking about a fairly significant investment that they would not want to see renegged upon at the conclusion of 2 years, 5 years, or something down the line.

[The information referred to follows:]

Anyone filing a petition may request a permanent exemption under the provisions of the Powerplant and Industrial Fuel Use Act of 1978. Since the implementation of the Act, 306 of 328 petitions for exemptions received have been for permanent exemptions. The remaining 22 requests were for temporary exemptions to allow burning of oil or gas during the construction of a facility that would eventually burn coal or an alternate fuel. 28 requests were dropped, withdrawn, or determined not to be necessary; the balance have been granted or are in process. The following table lists the petitions received by type of exemption and petitioner:

FUA EXEMPTION PETITIONS SUBMITTED BY FUA AND REGULATIONS CITE

[As of May 13, 1986]

Type	Act	Rule	Number of powerplants	Number of industrials
Temporary:				
Cost	211(a)	503.21	0	0
Site	211(a)	503.22	0	0
Environmental	211(a)	503.23	0	0
Synfuels	211(b)	503.23	[1] 1	1
Public interest	211(c)	503.25	[2] 8	[3] 12
Mixtures	211(d)	0	0	
Permanent:				
Lack of alt. fuel for first 10 years		503.31	0	0
Cost	212(a)	503.32	[4] 7	[5] 13
Site	212(a)	503.33	0	9
Environmental	212(a)	503.34	0	0
Lack of capital	212(a)	503.35	1	0
State and local requirements	212(b)	503.36	0	0
Cogeneration	212(c)	503.37	[6] 98	0
Mixtures	212(d)	503.38	0	[7] 47
Emergency	212(e)	403.39	0	5
Reliability	212(f)	503.40	18	9
Peakload	212(g)	503.41	98	0

FUA EXEMPTION PETITIONS SUBMITTED BY FUA AND REGULATIONS CITE—Continued

[As of May 13, 1986]

Type	Act	Rule	Number of powerplants	Number of industrials
Interm. load	212(h)	503.42	0	0
Process rgmt.	212(i)	....		
Scheduled out.	212(j)	503.43	0	10
Total			231	97

[1] 1 synfuels petition submitted. Facility plans dropped.

[2] 4 powerplant public interest exemptions dropped after issuance of interpretative ruling for auxiliary boilers.

[3] 3 industrial public interest exemptions dropped after granting permanent mixtures exemptions to the same units.

[4] 2 cost exemptions submitted by powerplants dropped after interpretative ruling for auxiliary boilers.

[5] 1 industrial cost exemption dropped after the planned fuel was determined to be a low-Btu waste stream.

[6] 8 cogeneratoin exemptions not needed or withdrawn.

[7] 3 mixtures exemptions terminated. 1 unit was classified existing, 2 were being fired with an alternate fuel.

Secretary HERRINGTON. My understanding from talking to the departmental staff, and has always been is that it is for a facility or for a given purpose, and it would be for the life of that, but I would like to check and make sure that we are uniform on that.

Senator NICKLES. I appreciate that, Mr. Secretary.

You mentioned on the pricing portions that you have estimated that EIA estimates that or you may have mentioned that consumers would save, if we were to adopt a comprehensive deregulation bill that consumers would save, what, $30 to $45 per year? Is that——

Secretary HERRINGTON. $25 to $45 is the DOE estimate.

Senator NICKLES. How do you explain that? Where do those savings come from? How does the consumer get the benefit of natural gas deregulation?

Secretary HERRINGTON. There is more gas that is being shut in now that is not being put in the market that would be released for the market. With more gas in the market, you have greater ability to compete with other fuels and other energy sources, and the price will fall.

Senator NICKLES. Some will say, wait a minute, you are deregulating some of these old contracts that maybe have prices as low as 40 cents, and those prices may escalate. Therefore if those prices escalate, how does that save consumers any money? How do you answer that?

Secretary HERRINGTON. The important thing is that today we have locked out of production too much of old gas because of restraints on gas. When I talk about lower prices and greater supplies, we are talking in an overall picture, not just the limited supply of gas that is in the market today.

Senator NICKLES. So if you release greater percentages of the older, cheaper gas, that might have a tendency to bring down the total aggregate price.

Secretary HERRINGTON. Yes. And there will be more gas sold, there will be more gas transmitted, more gas consumed, more jobs created. It is overall a tremendous benefit for the industry and all people connected with it.

Senator NICKLES. How did you come up with the $25 to $45? Is that a guestimate of something?

Secretary HERRINGTON. That is a conclusion that we have reached based on the amount of gas we see coming into the market and the increased activity and the increased ability for it to compete with other fuels.

Senator NICKLES. You also mentioned, I think I heard a figure of—what, about 30 trillion cubic feet could be additionally produced?

Secretary HERRINGTON. Yes.

Senator NICKLES. That is how much natural gas? That is what, about a 2-year supply?

Secretary HERRINGTON. Two-year current supply.

Senator NICKLES. Two years of annual consumption?

Secretary HERRINGTON. Yes.

Senator NICKLES. Senator Evans is here, and I have other questions I want to ask you. I have taken about 10 minutes, and I don't want to monopolize the time. I will come back to you, and I will allow Senator Hecht and Senator Evans to ask any questions they might like.

Senator Evans.

Senator EVANS. Thank you very much, Mr. Chairman. I just have a few.

Let me first, Mr. Secretary, concentrate to get a better understanding if I can of the supply situation and the estimates of current and future supply. It seems to me recent trends have been a dropoff in exploration and drilling activity. If we measure the addition to supply by the ratio of net additions to reserve divided by annual production, it has been under one apparently every year for the last 20 years except for a couple of years. What is happening to our total proven reserves?

[Pause.]

Secretary HERRINGTON. I think the main point, Senator, is that there is less and less exploration, and we are not adding to the reserves as we should be.

Senator EVANS. How will the proposed legislation in front of us correct that if in fact we are talking about actual lowering of prices rather than increasing prices? Doesn't that generally connote shrinkage rather than an expansion of exploration?

Secretary HERRINGTON. Senator, I would like to have Steven Minihan answer that particular question if I could.

Senator EVANS. And any of these questions you may want to expand in written responses, which would be helpful.

Mr. MINIHAN. Thank you. What is clearly happening, some drilling for new reserves is declining. What we would expect would happen is, by allowing our low cost gas to receive a higher price, some low cost wells will remain producing longer. That will not involve additional drilling. That well will simply remain in production, or we will drill infill wells that are less costly than some of the new drilling that could occur. And the third source would be simply going back to an old well and enhancing the production from that well, because you get a higher price, although that price is still much lower than the current market price.

Senator EVANS. Maybe this needs to be answered with a written response, but given a little better sense of the whole question of supply and potential future supply, isn't our proven reserves, or are not our proven reserves based on a certain assumed level of sales price? In other words, you have to assume a sales price before you know what is economically recoverable. Is that right?

Mr. MINIHAN. Exactly.

Senator EVANS. Are we estimating proven reserves then currently on the basis of a price that is higher than we could expect to get at any time in the near future, or is that realistic?

Mr. MINIHAN. I think that there is quite a wide range of uncertainty around what people think the current economics are. I think current reserves are about 200 trillion cubic feet.

Senator EVANS. That is 200 trillion at what kind of price?

Mr. MINIHAN. At roughly today's prices, a dollar higher, a dollar lower. I think that range of uncertainty would clearly cover 200 trillion feet, but clearly the gas is in fields that have already been discovered and are already producing, and it is a bit of an issue how low the price can go before you quit producing. Those are variable costs of production which are much lower than the cost of drilling.

Senator EVANS. How much of those proven reserves are in Alaska? If it is a large share in Alaska, how important to you is the consruction of a pipeline that connects Alaska with the lower 48?

Mr. MINIHAN. I believe the reserves in Alaska of natural gas are 20 to 26 trillion cubic feet. We estimate there are 20 to 24 trillion cubic feet of low-cost gas that could be produced when prices rise high enough to cover the transporting of that natural gas down to the lower 48.

Senator EVANS. How high does that have to be?

Mr. MINIHAN. I think the estimates I have seen in the past would be very uncertain; $5 to $7 a thousand cubic feet, I think, covers most costs.

Senator EVANS. Mr. Secretary, in parts of your testimony you talk about the need for comprehensive legislation. While that, you feel, may be desirable or best, is it really necessary? In other words, isn't the current immediate problem one of demand restraints? And if that is the case, would we take a major step forward if we corrected that problem without necessarily at the same time handling the problems of transportation access?

Secretary HERRINGTON. Senator, I have to say again that one of the major problems that we see is the transportation, that is, the producers getting their product to the market.

Senator EVANS. I hate to interrupt, but if you would rank the various elements of difficulty now, would that be your top priority?

Secretary HERRINGTON. I would say the decontrol of the prices and the transportation are the most important things.

Senator EVANS. On price, is there some indication the marketplace itself is handling the market price problem in some producing areas today? I understand that in some cases gas has fallen even down below a dollar.

Secretary HERRINGTON. I think in some cases we can see that, but I think overall that would not give any evidence that the status quo was acceptable.

Senator EVANS. Perhaps not, but if the marketplace itself is driving down prices, how necessary is it to have wellhead decontrol at this time?

Secretary HERRINGTON. For 15 to 20 percent of the gas there is no marketplace. It is shut in because of regulation. If FERC should rule to eliminate vintaging and allow the price on all old gas to float up to about $2.57 we might solve some of the problem, but we wouldn't solve the transportation problem.

Senator EVANS. One final area. How do you expect a comprehensive piece of legislation as you are suggesting would affect the relationships currently existing between Canada and the United States in terms of gas supplies, price? What is most likely to happen, in your view?

Mr. MINIHAN. We think the price for natural gas would come down as a result of greater competition from domestic gas production, but the United States policy covering Canadian imports and Canadian import policy is very flexible. There does not seem to be any problem with the Canadians lowering their price to remain competitive with the United States.

Senator EVANS. Along with the decontrol, would you suggest removing whatever barriers there might be from reflow of gas to the United States?

Senator BUMPERS. Would you repeat that, Dan?

Senator EVANS. With all the movement toward decontrol, would you suggest we ought to eliminate whatever barriers, if any, exist in the free flow of gas between Canada and the United States presumably, from Canada to the United States, presumably?

Secretary HERRINGTON. I think it is relatively free now. The movement of anything that allows the sources of this product to compete with each other to the benefit of the consumers I would like to look at, but I do not see many restraints today. In fact, some of the complaints are, we are importing too much gas.

Senator EVANS. That is what I had in mind with the question. Some would like the marketplace to determine, as long as it is marketplace in this country, but build barriers at the border so we do not have too much competition. I am not quite sure what you would call that, a semimarketplace, or whatever, but as far as you are concerned, you would just as soon see no restrictions or—from what I understand from your answer, there are not many that you are aware of today, and if there are many you do not particularly support them?

Secretary HERRINGTON. I cannot think of any. Maybe in some isolated cases, but I do not—I think it is a relatively free market at this point.

Senator EVANS. And you would suggest keeping it that way?

Secretary HERRINGTON. I think low-cost energy is good for the economy, and I would like to see it.

Senator EVANS. Thank you, Mr. Chairman.

Senator NICKLES. Thank you very much, Mr. Chairman.

Senator Bumpers, I have got some more questions. Do you want some more time?

Senator BUMPERS. If you would, I would like to have about 10 more minutes.

Senator NICKLES. OK, I would be happy to.

To follow up on that question, Mr. Secretary, it has always irritated the heck out of me to see us paying a lot more for Canadian imports than we do pay our domestic producers. Is that gas not just as old in Canada as it is in the United States?

Secretary HERRINGTON. Yes.

Senator NICKLES. I mean, does it make any real sense to limit prices on gas to American producers to levels in many cases, some well below whatever the market price might be, and yet be paying Canadian producers three times, as much as five times? The latest average import price from Canada was $3.18, and we are trying to sell gas for $1.40 in Arkansas and Oklahoma. There seems to be almost—with the distortion of natural gas price controls and the fact that we have discriminated and hurt domestic producers to the advantage of imports and other producers.

Secretary HERRINGTON. I think that is true.

Senator NICKLES. I would think that the real solution would be deregulation instead of regulating imports and what the prices would be. Would you agree with that?

Secretary HERRINGTON. Yes.

Senator NICKLES. I appreciate your comments.

A couple of other questions on the price side of your bill. You have a section in the bill that deals with area rate clauses. We touched on that on your statement before in the committee. Could you again tell us how those contracts under—I am going to say primarily 104's that have area rate clauses in those, how that section would operate?

Mr. MINIHAN. That section of the bill would keep the price for that gas at the price that gas was receiving the day before removal of price controls in order to prevent the definite price escalator provisions of the contract from coming back into effect, and that is because there was a period that FERC would only allow area rate clauses in those contracts as indefinite price escalators.

Senator NICKLES. So would you give us an example, Steve, of how that would work? You had an old contract that had some area rate escalators. You are thinking if it was decontrolled that those would go back to the original price?

Mr. MINIHAN. If the regulated rates were gone, the area rate clauses would no longer be activated by the regulated price the Government set. As a result, it is possible that those prices in those contracts would fall back to a definite price escalator that existed in a period that originally the contract was written. When producers and pipelines tried to renegotiate that contract the Federal Power Commission [FPC], I believe, at the time would not allow the producer, and the pipeline to agree to any other indefinite price escalator except an area rate clause, so the original definite price escalator can become the effective price term after decontrol without this provision of the bill.

Senator NICKLES. Would the rates fall back to what is sometimes called a minimum rate gas?

Mr. MINIHAN. Yes.

Senator NICKLES. All producers in looking at the price of that today would be 32 cents?

Mr. MINIHAN. I think that is right.

Senator NICKLES. A couple other questions. Moving over into the transportation and the carriage provision, looking at the carriage provision, basically it just says the Commission shall direct an interstate pipeline to provide transportation service without discrimination unless they can demonstrate to the Commission that it is incapable of rendering that service.

Some pipelines or associations will claim that without discrimination standard of carrying provision on the administration's bill is unworkable, and that it could render illegal such common practices as volume discounts and mileage sensitive rates. It could cause them problems with their contracts. Would you care to address or answer that allegation?

Secretary HERRINGTON. I think the important thing on that particular point is, so long as volume discounts, that sort of thing, are offered to everyone, there is no problem with it. What we are talking about is nondiscriminatory type activity, so I would say that criticism probably is without merit.

Senator NICKLES. Some pipelines may come back and say, well, if you are going to mandate that we carry this gas without discrimination, we carry it for anybody, any producer that comes up or any buyer that says, yes, we want to purchase this, carry it for us on a carriage basis, in other words, not buying it but just transporting the gas, that that is their leverage, to use that to trade for a reduction in maybe some contracts that are not market sensitive. They want to trade access to pipeline for reduction in take or pay contracts, feeling like you are mandating them giving away one of the tools that they would use at the bargaining table. How would you respond to that?

Secretary HERRINGTON. That is not a market tool, because there is no alternative to the producer that wants to sell its product into the market. If you are sitting with that type of a club over your head, I think it becomes very difficult to do this, and the sole purpose of our transportation clause in this proposal, Mr. Chairman, is to put the burden back on the pipeline to show it cannot transport on a fair, nondiscriminatory basis.

Senator NICKLES. Do you have enough data to estimate on the number of pipelines that look like they are going to be participating under 436?

Secretary HERRINGTON. I think the participation in our estimation has been very disappointing at this point, not just because of the pipelines themselves, but maybe because of the way it was written, maybe because of the way of signing up for it was structured, but it has been not satisfactory at this point.

Senator NICKLES. How many pipelines do you now have that look like they would be participating in the 436?

Mr. MINIHAN. I believe that about on the order of 10 major interstate pipelines have informed FERC that they are interested and would like to enter into a settlement process to become 436 carriers, and of course one of the concerns we have, and I think EIA wrote a study to this effect, is that that settlement process is not entirely clear in terms of whether or not it will meet the intention of order 436, whether or not pipelines and end users will come out of that process with the type of nondiscriminatory transportation we had in mind.

Senator NICKLES. I had a list. I would appreciate it if you would provide for this committee a list of those who have applications pending or filed for blanket certificates under 436, mentioned those companies were interested in the status. As you know, this Senator, at least, and I think other members of the committee have urged, one, FERC to postpone their date, trying to assist pipelines and others so they could be participants in the system, although I would agree, Mr. Secretary, with your comment that it has not been satisfactory to date.

We hoped that the rates and other things would be taken care of so we would start moving more gas through the market. I am not sure that this carriage section under Senator McClure's bill—do you think that would solve most of the dilemma that we now have pending before the FERC?

[The information follows:]

Thus far, only one pipeline is operating under an Order 436 transportation certificate. It is unclear how many other pipelines will ultimately seek and accept an Order 436 rate schedule and transportation certificate. Several other pipelines are currently in negotiations with their customers for transportation rates and conditions. Others have only recently taken the first of many steps in adopting Order 436.

As part of the process of obtaining an Order 436 certificate, pipelines must obtain agreements from their customers on new tariff rates. The rate settlement process involves the following steps: A pipeline must first file a rate schedule. Then, any objections from its customers can be resolved through a process of comments, reply comments, and review by an administrative law judge, or through direct negotiation and settlement between the pipeline and its customers. The final rate schedule must be approved by the Commission.

In addition to applying for new rates, a pipeline must apply for a blanket transportation certificate in order to carry gas as a contract carrier. This certificate is also subject to comments and review by interested parties and must also be approved by the Commission.

As of June 5, 1986, only Columbia Gas Transmission/Columbia Gulf was transporting gas under an Order 436 certificate. Columbia has not received approval for its proposed rate settlement. Rates for transportation by Columbia are currently determined under an interim rate schedule, pending final FERC approval of Columbia's proposed rates.

El Paso Natural Gas has submitted a proposed rate settlement that has been approved by FERC with conditions. El Paso is reviewing these conditions before deciding to accept or reject the approved settlement.

Five other pipelines are in the rate settlement process with their customers. About fifteen other pipelines have submitted rate schedules as a first step required to receive an Order 436 transportation certificate. FERC had originally set a May 30 deadline for the submission of proposed rate schedules, but FERC has allowed some rate schedules to continue to come in after the deadline.

The filing of rates by a pipeline does not necessarily indicate that it will seek an Order 436 certificate. Pipelines were required to have rates on file by May 30 to be eligible to carry gas for others by July 1, the starting date for Order 436 (assuming the rates have been accepted and a blanket certificate received). Throughout the long process of comments and review, the pipeline has the option of withdrawing its application. A pipeline is not officially an Order 436 carrier until the final rate settlement and blanket transportation certificate have been accepted by the pipeline, its customers, and the Commission.

The following tables shows the status of the tariff rate and transportation certificate applications of the major interstate pipelines.

Status of Applications for Order 436 by Major Interstate Pipeline Companies (as of 6/5/86)

Rate Settlements

Company	Date Filed	Status	Comments
El Paso Natural Gas	3/21/86	Approved by FERC, with conditions, 5/29/86	El Paso reviewing conditions
Consolidated	2/10/86	Pending	Certified to the Commission
Texas Eastern	3/13/86	Pending	In comment period
Transwestern	3/24/86	Pending	Certified to the Commission
Transco	3/28/86	Pending	With Administrative Law Judge
Northern Natural	4/11/86	Pending	In comment period
ANR	4/28/86	Filed rates	
Arkla	5/30/86	Filed rates	
Colorado Interstate	5/30/86	Filed rates	
Columbia Gas/ Columbia Gulf	5/30/86	Filed rates	
Florida Gas	5/30/86	Filed rates	
Great Lakes	5/30/86	Filed rates	
Midwestern	5/30/86	Filed rates	
NGPL	5/30/86	Filed rates	
Northwest	5/30/86	Filed rates	

Panhandle	5/30/86	Filed rates
Sea Robin	5/30/86	Filed rates
Southern	5/30/86	Filed rates
Texas Gas	5/30/86	Filed rates
Trunkline	5/30/86	Filed rates
United	5/30/86	Filed rates
Tennessee	expected	

Blanket Transportation Certificates

Company	Date Filed	Status
Columbia Gas/ Columbia Gulf	12/13/85	Approved, 2/28/86, 2/25/86
Consolidated	2/10/86	Pending
Texas Eastern	3/13/86	Pending
Transco	3/28/86	Pending
Northern Natural	4/11/86	Pending
Texas Gas	5/30/86	Pending
Tennessee	6/3/86	Pending

Secretary **Herrington**. We feel that it would. We feel that any person would be able to apply to the FERC and be able to make a case, and it would allow, if it is structured correctly, a fair and impartial nondiscriminatory process for allowing producers to get their product to market and allow open access.

Senator **Nickles**. Do you think that would probably be one of the most beneficial aspects of the proposal as far as the consumers are concerned?

Secretary **Herrington**. I think if we fall short of that goal at this time we make a major mistake, and I think it is very important to address transportation to solve this problem. If we do not do it now, when are we going to do it?

Senator **Nickles**. In addressing the transportation issue, and again, I go back to some of the statements made by many in the pipeline industry of enormous take-or-pay liabilities, they are concerned about transporting gas, maybe that bypassing them, losing some contracts or something, but still having very large take-or-pay liabilities with producers and a great deal of litigation, many times—or I have heard the take-or-pay liability being in excess of their net worth.

Have those high cost contracts, do you have information to show whether or not—we have some groups I think that will testify shortly that say a great percentage of those contracts have been renegotiated in a more market-sensitive range, and I think we will hear some of the pipelines say that there is still a very significant problem, and they would be willing to accept some form of carriage if they had some tradeoff in take-or-pay reductions.

Secretary **Herrington**. We agree with the first position, that overwhelmingly a large majority have been renegotiated. The problem is being overstated.

Senator **Nickles**. Do you have information to back that up? Has anybody surveyed all the pipeline producers or anything to get some kind of idea how much take-or-pay responsibility is out there?

Mr. **Minihan**. I think a few associations have, and there is some disagreement there.

Senator **Nickles**. That is a mild statement.

Mr. **Minihan**. But this, I think, is really a very important part of it. This is data collection of actual transactions. It is showing for 102 prices on average those prices are coming down even for the contracts signed back in the period when take-or-pay agreements were quite high because oil prices were so far above gas prices and the regulated ceilings were below those alternative fuel prices.

So, the price data we are seeing is coming down. The take-or-pay settlements, I believe, in the EIA report they found that 3.5 billion had been renegotiated, which was equal to the entire pre-1984 take-or-pay liabilities.

Senator **Nickles**. Am I not correct in that the recent EIA data shows that some deregulated 102 gas is selling for less than other forever regulated 102 gas?

Mr. **Minihan**. Some deregulated is lower than forever regulated?

Senator **Nickles**. Correct.

Mr. **Minihan**. I do not remember seeing that.

Senator **Nickles**. Could you provide that for us?

Mr. **Minihan**. Yes.

[The information referred to follows:]

ACTUAL AND PROJECTED PRICES AND VOLUMES OF NGPA SECTION 102 NATURAL GAS

	Actuals—1985		Projections—1986	
	Volume (bcf)	Price ($/MMbtu)	Volume (bcf)	Price ($/MMbtu)
Decontrolled:				
102 OCS new	571	$3.15	564	$2.66
102 onshore	1,144	3.25	918	3.09
Controlled:				
102 OCS old	855	3.72	635	3.83

Source: FERC PGA filings for 51 interstate pipelines, January–June 1986. Actuals are through 3d quarter 1985. Projections are through December 1986.

Senator NICKLES. Senator Bumpers, did you have questions for us?

Senator BUMPERS. Mr. Secretary, in looking over the statistics here that have been supplied to me, the estimate is that—let me make sure I can find it again, the estimate here is that in 1985 U.S. production will be 16.41, I guess that is TCF, and the consumption will be 17.50, and I assume the difference there is in imports. Is that correct?

Secretary HERRINGTON. I think that is correct.

Senator BUMPERS. Are we importing gas from Mexico?

Secretary HERRINGTON. Canada. Canada is our main——

Senator BUMPERS. Not from Mexico?

Secretary HERRINGTON. No, sir.

Senator BUMPERS. Why do we not import from Mexico?

Secretary HERRINGTON. I think there is a disagreement on price. I do not think they are willing to export at the price that is market.

Senator BUMPERS. Has any attempt been made lately to talk to Mexico again in light of the decline in oil prices and the state of their economy?

Secretary HERRINGTON. We did discuss this within the administration as late as last week.

Senator BUMPERS. And what?

Secretary HERRINGTON. There is no conclusion. We are looking at it. The Treasury Department obviously is negotiating not only with continued purchases of crude oil for SPR, which we are talking about, but also other methods to get energy sources from them.

Senator BUMPERS. I am looking at a chart here that shows the average domestic wellhead price in 1985 was $2.09 for 1985.

Secretary HERRINGTON. I would agree with that.

Senator BUMPERS. And that 1986 is going to be $1.65. Now, that is almost a $1.30 decline in prices for 1986. Am I still right or is that wrong?

Secretary HERRINGTON. I think that is correct.

Mr. MINIHAN. I think the $1.65 for average price is too low for 1986.

Senator BUMPERS. This came from your report. Do you want to throw it away?

Mr. MINIHAN. A $1.65 is if you deregulate all gas prices.

Senator BUMPERS. The reason I was confused about this is because the bill does not anticipate going into effect until 1987.

Secretary HERRINGTON. April 1987.

Senator BUMPERS. April 1987, and you are showing a $1.65 price here a year before it goes into effect.

Mr. MINIHAN. Yes, that is right. We have $1.65 in for a low oil price case. For our high oil price case—that is in the preceding page—we have $2.74.

Senator BUMPERS. I see that. That is also a decline from 1985 by a few cents, 20 to 30 cents.

Mr. MINIHAN. Yes, sir.

Senator BUMPERS. Now, my question is, I assume that this precipitious decline in the average wellhead price is due to supply exceeding demand. Is that correct?

Secretary HERRINGTON. Yes.

Mr. MINIHAN. And quite a bit of it is the assumption about oil prices, and we have used a range there. The chart you have read assumes oil prices at $14.

Senator BUMPERS. My chart says $13. Is it $13 or $14?

Mr. MINIHAN. I believe I have inflated it to 1986 dollars, but that is roughly right. I would not argue that, but it is a range of that number, $13, $14 a barrel. In the next——

Senator BUMPERS. Can you tell me off the top of your head, in light of the fact that oil prices went to $17 yesterday, what that would be?

Mr. MINIHAN. The average price is about $2.47 per cubic foot.

Senator BUMPERS. So the $1.65 is erroneous?

Mr. MINIHAN. It is the low end of the range.

Senator BUMPERS. Even if it is the low end of the range, obviously the price, natural gas prices have been declining?

Mr. MINIHAN. Yes, sir.

Senator BUMPERS. My next question is, do you want to deregulate gas because you think it will drive price down, or do you want to deregulate gas because you think it will spur incentives, or do you want to deregulate gas because you think it will get rid of an awful lot of redtape for everybody and maybe get rid of some inequitous contracts, or is it all three?

Secretary HERRINGTON. I think it is all three, Senator, in various degrees, but I think it is all three.

Senator BUMPERS. Just pursuing the line of questions that Senator Evans asked, why would you decontrol if the marketplace is working anyway because the prices are set as a ceiling, not a floor, and if the supply exceeds demand, why would prices not continue to decline without the necessity of deregulating?

Secretary HERRINGTON. I think the market is working as to that portion of the gas that is already decontrolled, but the market is definitely not working as to that gas that is being shut in by artificially low prices, but we are talking——

Senator BUMPERS. How much gas has been shut in because of low prices?

Secretary HERRINGTON. About 45 percent of natural gas is still controlled.

Senator BUMPERS. Are these figures you are giving me only applicable to decontrolled gas, gas in which contracts have expired, or what? This is not all gas?

Secretary HERRINGTON. I think it is an average. It is all gas.

Senator BUMPERS. What were our reserves at the end of 1985?

Mr. MINIHAN. About 200 trillion cubic feet.

Senator BUMPERS. How does that compare with 2 or 3 years ago?

Mr. MINIHAN. I do not have that number, but I think they are quite close.

Senator BUMPERS. Very similar?

Mr. MINIHAN. Yes.

Senator BUMPERS. Incidentally, here you assumed that in 1995 we will produce, if the administration bill passes, you show a decline, a pretty significant decline to 15 trillion cubic feet by 1995. Is that correct?

Mr. MINIHAN. Yes, sir.

Senator BUMPERS. Even with decontrol?

Mr. MINIHAN. And the low oil prices.

Senator BUMPERS. Does your model assume that by 1995 finding gas in this country will be increasingly difficult, and that is the reason the decline in production is going to occur?

Mr. MINIHAN. I think it clearly is going to get more difficult to find gas in the United States, but quite a large part of that assumption as well is that projection we used on the low side assumed oil prices would only get back to about $24 a barrel by 1995.

Senator BUMPERS. That is a very risky assumption, do you not think?

Secretary HERRINGTON. [Nods affirmatively.]

Mr. MINIHAN. For a low assumption I think it is not that risky, no. A low oil price projection.

Senator BUMPERS. What is the spot price of gas right now?

Mr. MINIHAN. It varies, but I think in the gulf coast it is around $1.40, and I believe it gets as high as over about $2.50 in Appalachia, the different areas where the spot market transactions occur.

Senator BUMPERS. What is the average wellhead price of 104 gas right now?

Mr. MINIHAN. I believe it is about $1.35.

Senator BUMPERS. If the Congress should decide to go along with either—Don, is your bill the administration bill?

Senator NICKLES. No, it has different provisions on how we handle old gas. Ours does not have a carriage provision, but we are looking at a carriage provision.

Senator BUMPERS. I might say that I do not see how you can decontrol gas unless you deal with a host of other problems concurrently with it, including the contract carriage and the Fuel Use Act, and so on.

And while I normally have some difficulty with this, I am going to be openminded on it, because I recognize that we have a serious problem with gas pricing, but let me ask you this. If Congress were to go along with the administration's proposal, how about gas contracts between lessors and lessees on royalties? Where the royalty contract is set in stone, not one-eighth, but we will say one-eighth of 50 cents or some such thing as that, those contracts are obviously entered into either in the old days or in anticipation of a regulated price of a certain amount.

Now, would you be willing to abrogate those contracts and say that the royalty owner only got one-eighth of whatever the price is, regardless?

Secretary HERRINGTON. I do not think so, Senator. We do not believe that abrogation of any contracts in the administration of this is a good idea.

Senator BUMPERS. So you are saying that if 15 years ago a contract was signed where the lessee gets one-eighth of the value of the gas, said value to be calculated at 15 cents, and that gas is now bringing $3, that the royalty on it ought to get one-eighth of 15 cents?

Secretary HERRINGTON. I believe if it was fair——

Senator BUMPERS. I can tell you there are thousands of contracts like that, Mr. Secretary.

Secretary HERRINGTON. Yes, I understand.

Senator BUMPERS. You think the lessee, the lessor ought to be stuck with that royalty?

Secretary HERRINGTON. That he get what he bargained for at the time he signed the contract, I think, is the question.

Senator BUMPERS. You do not think equity plays any role in this?

Secretary HERRINGTON. I think it plays a role in it, but the first house I bought was $17,000. I would like to sell that house at today's market, but you enter into the contract at the time you enter into it, and I think that contract needs to be kept.

Mr. MINIHAN. Mr. Senator, I think it is also true that many of those contracts, the contract price after deregulation would become a market price, and I believe many of those royalty owners would get one-eighth of that market price.

Senator BUMPERS. Most of them will, but I am looking after a very small group of people in my State who signed contracts back in the late forties and all during the fifties and early sixties for one-eighth of a specific amount.

Mr. MINIHAN. If that contract price remains at a specific amount, and some contracts we have estimated about 10 percent of the old gas contracts are under definite price escalators that will not be affected by our bill unless the purchaser and the seller voluntarily negotiate a new price.

Senator BUMPERS. Let me ask you this. What about if, and I do not know that there are any such contracts, but if there were contracts where the amount was set at one-eighth of the value of the gas, and the value was set at the regulated price, and then you deregulate it and the price doubles over the next 5 or 6 years, would you not think that that royalty on it ought to be entitled to one-eighth of whatever the price goes to?

Secretary HERRINGTON. I think in many cases that royalty owner would get that, as long as the contract allows that new price. I do not know of any contracts—and we could look—that would get a deregulated market price, but the royalty owner would still only get his royalty calculated based on the prior regulated price.

Senator BUMPERS. Let me give you a scenario. Let us assume that I am a lessor and I have leased a section of land on which there is a gas well. In my State a section is the drilling unit.

And let us assume further that I signed a contract at the regulated price, we will say, of $1.40 cents at that time, and I get one-eighth of $1.40. And assume further that gas is deregulated and it goes to $2.80.

Now, why would it not be fair to say that royalty, that under this bill that royalty owner shall not receive less than one-eighth of whatever the gas is. If the gas goes down, then the royalty owner will get less than he is getting now.

And you are assuming here, incidentally, that prices are going to decline in many instances. But if it goes up, why should he not participate in that? He is willing to take a risk one way if the lessee is willing to take a risk the other way.

Secretary HERRINGTON. This was a contract signed in 1940, you said?

Senator BUMPERS. No, I am talking about a contract signed—when was the Natural Gas Act, 1978?

Secretary HERRINGTON. Do the terms of this contract say he will get one-eighth of $1.40 or——

Senator BUMPERS. Let us say one-eighth of $1.40 or one-eighth of the regulated price. If there is no regulation, of course, you would at least have a lawsuit with a fighting chance.

I can tell you, there are an awful lot of people in my State who are getting one-eighth of 40 and 50 and 60 cents, even though the gas is bringing more than that.

Secretary HERRINGTON. And those contracts did not provide for deregulation in the future, and if that should change by an act of Government then it would be one-eighth of the market price?

Senator BUMPERS. I promise you, that is what some of them say. Of course, there are a lot more—there are a lot more, Senator Nickles, that say the lessor shall receive one-eighth of the value of the gas, that value to be calculated at the rate of 15 cents.

There is a little deception there, you know, it seems to me, because most people always think in royalty terms of one eighth. So when some guy who could barely read and write, or certainly was not capable of interpreting a contract, saw one-eighth, that is just what he assumed he was getting. One day he looked and it said it is at one-eighth of the value of the gas, which is what he thought he was going to get. Then the extra clause said, to be calculated at the rate of 14 or 15 cents.

Secretary HERRINGTON. Our feeling is that the overwhelming majority of these contracts provide for deregulation to change the royalty. That is what we have seen. I am not sure how much of a percentage.

Senator BUMPERS. I think this is fairly isolated. I am not suggesting that this is something that has occurred all across the country, because I doubt that it has. But I am just saying I know an awful lot of—I used to do a little oil and gas practice. When I first got out of law school, I was going to tear all those contracts up, but I found out that was not possible.

Senator NICKLES. You did not write those contracts? [Laughter.]

Senator BUMPERS. No. I will tell you, when I got out of law school those contracts said one-eighth of the value of the gas, said value calculated at 4 cents an mcf. And so when I started, some people came to see me and I was getting ready to file a lawsuit, they upped it to 7 cents voluntarily.

And I still had several clients ready to go to bat, and when they got to 14 cents I lost all my clients. So I never really got a chance to test it. I probably did not have all that good a chance anyway.

But I am concerned, and I can tell you there are an awful lot of people in my State that are concerned, about some of those old contracts.

Now, if, pursuing again—I want to nail this down. I have asked you this once, but I want to ask you again. If there is a glut of oil—I mean, of gas right now, and gas prices have declined to 1986 from 1985 as precipitously as your charts indicate, what is the primary purpose for deregulating?

Secretary HERRINGTON. I think there are several purposes. One, I think there are a lot of geographical distortions in this country on who can get gas and how they get it and what price they pay.

There are also distortions on producers that have gas and want to sell it and buyers who want to buy it, who cannot get together because of no access to the pipelines or discriminatory type access. I think in some cases the system is working very well, but in the overriding majority of the cases it is not working well.

The purpose of this legislation is to free up more gas for the market, should the market call for it, and allow more gas to compete with other types of energy in this country. The second purpose is to provide for transportation. A willing buyer and a willing seller want to get together at a negotiated price in the marketplace, and that they be allowed to get together.

The third is to repeal the Fuel Use Act and the incremental pricing.

Senator BUMPERS. What about take-or-pay contracts? That seems to be the biggest burden producers have. How would you deal with that?

Secretary HERRINGTON. We think that the voluntary renegotiation of take-or-pay contracts is the right solution.

Senator BUMPERS. You think what?

Secretary HERRINGTON. The voluntary renegotiation of the take-or-pay contracts is the right solution to that problem. We do not feel there should be any——

Senator BUMPERS. I said producers a while ago. I did not mean producers.

Go ahead.

Secretary HERRINGTON. We do not support abrogation of any contracts, and we think the problem is not——

Senator BUMPERS. You feel the same way about those contracts as the one I mentioned a while ago? We should not abrogate contracts for any purpose?

Secretary HERRINGTON. I think there are similarities.

Senator BUMPERS. How much gas consumed in this country, if you know, is subject to take-or-pay contracts?

Mr. MINIHAN. I believe most gas contracts are subject to take-or-pay provisions. What varies is the percentage level of the take or pay. That take or pay prior to, I think, the Arab embargo was on the order of 60 percent. It grew as high as 80 to 90 percent after the embargo, with oil prices very high.

And recently, with oil prices dropping and partial decontrol, those take-or-pay provisions are falling in percentage terms for new contracts.

Senator **Bumpers**. Mr. Secretary, what about the Alaska pipeline? Is that dead for the foreseeable future?

Secretary **Herrington**. For natural gas?

Senator **Bumpers**. Yes.

Secretary **Herrington**. I think it is.

Senator **Bumpers**. We are just going to lose all that gas up there because we cannot finance the pipeline?

Secretary **Herrington**. I do not have a solution this morning for it. I think there are a lot of problems, and I know it is still under discussion. But I do not see the answers as I sit here that I can testify to.

Senator **Bumpers**. Obviously, if we could not build it back when prices were twice as high as they are now, you cannot build it at today's prices. But it certainly seems to me a tragedy, and I do not know what will happen with the gas.

I am not a technician in the oil drilling business, and I do not know how much longer they can reinject the gas to keep it in the ground, waiting for the price to go up and the pipeline to be built. But ultimately, the way we are going right now, we are going to lose all that gas up there. Is that right or wrong? I have not thought about it for a long time.

Secretary **Herrington**. I have not, either.

Senator **Bumpers**. Let me just finally ask you this question. Given the time left in this Congress—and we have got more poured out than we can smooth over already without this—and considering the fact that there will be filibusters in the Senate and probably an unhappy reception over in the House, it just seems to me that it is going to be very difficult to get a comprehensive deregulation bill passed.

I was just wondering, would it not be better if we could just deal with the Fuel Use Act, repeal some sections of that which are particularly onerous in this business, and take something less than a half loaf? Because I just know the nature of this place and I know all the work we have left, and I know what we have to consider, and I think the timeframe on it is very difficult.

Secretary **Herrington**. There are a couple of points I would like to make. I know that it is difficult. There is no question it is difficult. But it is right. That is the important thing.

There are a lot of issues up here that you all deal with that you know are right, but they are difficult. I think that the difficulty—but that does not make it any less worthy a cause for you to look at.

The problem in the House side, I would like to urge you to keep an open mind on that. I believe that action in the House can take place and can take place soon. And I would like you to be open minded on that particular point.

It is correct that it is difficult. I do not think the Fuel Use Act alone is even a half a loaf. I would hesitate to even estimate how much of a loaf it is. We had 104 exemptions to the Fuel Use Act, exemptions alone last year. They are not hard to get. They have never been denied.

The Fuel Use Act is symbolic. It is not having any purpose at this point, most of the provisions of it. And to repeal it and then say the job is done, standing alone, I think would be a mistake because it would not be bringing transportation, lower cost, more production, all the benefits that we have been talking about.

Senator BUMPERS. Mr. Secretary, I will be interested in hearing what some of the producers and some of the people in the industry have to say about that, because I understood that that was one of their primary goals.

Does that mean that you would not favor dealing with the repeal of the Fuel Use Act if we cannot get the whole bill?

Secretary HERRINGTON. I strongly favor repeal of the Fuel Use Act and incremental pricing. I just think that at this time in our economy and where we are today in our oil prices and energy costs, and at this time when we are so focused on energy sources, will we always be tied to this crude oil dependency that we have?

We have problems with acid rain legislation that is hurting our coal industry. We have the Chernobyl incident that is hurting our nuclear industry. I see a lack of replacement of crude oil reserves in this country, increasing imports.

Any opportunity to put another energy source in in abundance, I think we are making a great mistake if we do not allow this to flow into our energy mix.

Senator BUMPERS. Mr. Secretary, since I have you here, if the chairman will indulge me in this one question. Do you think this committee ought to hold an oversight hearing on the safety of our nuclear reactors and the evacuation plans at each one of them?

Secretary HERRINGTON. I think the NRC does a good job in regulating our nuclear reactors.

Senator BUMPERS. We thought NASA was doing a good job, too.

Secretary HERRINGTON. I agree, sir. But I think since Three Mile Island you, along with many of the Senators, have followed this thing very carefully, and you know the painstaking efforts they go through in the regulation of nuclear reactors.

I do not think you can compare any commercial reactor in this country today with what happened at Chernobyl. Basically, we do not have a commercial reactor in this country, with the exception of the Fort Saint Vrain reactor, that has a graphite core.

And we have far more precautions in the two graphite core reactors in this country than Chernobyl had.

Senator BUMPERS. I am not suggesting that our reactors are not better designed and much safer and much safer operated. But to give you an illustration, the two reactors at Indian Point—you know where those are, I assume?

Secretary HERRINGTON. Yes, sir.

Senator BUMPERS. I understand that the evacuation plans for Indian Point call for evacuation of a 10-mile perimeter. And the Soviets will tell you right now that they evacuated around 18 miles and wish they had done more. And there are 10 times as many people within 20 miles of Indian Point as there was within 20 miles of Chernobyl.

So I am just saying that, completely aside from reactor design and reactor safety, some of these evacuation plans are woefully inadequate in my opinion, and I think this committee is going to be really abdicating its responsibilities if we do not look at those things.

Mr. Chairman, I thank you very much for indulging me. Thank you, Mr. Secretary.

Senator NICKLES. Mr. Secretary, we need to leave. You have been Secretary of Energy for how long?

Secretary HERRINGTON. February 1985.

Senator NICKLES. February 1985. Are you aware of the fact that the last rig count was 757?

Secretary HERRINGTON. Yes, I am.

Senator NICKLES. And under your tenure, then, the number of active rigs has [laughter] fallen pretty dramatically.

Senator BUMPERS. How secure do you feel in your job, Mr. Herrington? [Laughter.]

Secretary HERRINGTON. I think it is the lowest point since World War II and in some figures before World War II. And it is not a happy situation.

Senator NICKLES. I just wanted to make sure that you were aware of that.

Secretary HERRINGTON. I am well aware of it, on a daily basis.

Senator BUMPERS. I think that is one of the best arguments for the bill.

Senator NICKLES. I appreciate you coming back before the committee. I know you did in a previous hearing. Thank you very much.

We will have additional questions to submit to you. You did answer our previous questions. Thank you very much.

[Subsequent to the hearing the Department of Energy submitted the following:]

Department of Energy
Washington DC 20585

June 12, 1986

Honorable James A.McClure
Chairman, Committee on Energy
  and Natural Resources
United States Senate
Washington. D.C. 20510

Dear Mr. Chairman:

On May 20, 1986, Secretary Herrington appeared before the Committee on Energy and Natural Resources concerning natural gas deregulation legislation, S. 834, S. 1302, S. 1251, S. 2205, and S. 2285.

Following that hearing, you submitted a written question for our response to supplement the record. Enclosed is the answer to that question, which also has been sent directly to the Committee staff.

If you have any questions, please have your staff call or Cathy Hamilton on 252-4277. They will be happy to assist.

Sincerely,

Robert G. Rabben
Assistant General Counsel
for Legislation

Enclosure

QUESTIONS FROM SENATOR NICKLES

Question 1.: Please show for each year since enactment of the NGPA:

A. the amount of gas flowing under each section and under each subsection of the NGPA; and

B. the average price of the gas by section and subsection.

Answer: A complete record of yearly volumes and average prices is not available for natural gas flowing under each section and subsection of the NGPA. An EIA report, Drilling and Production Under Title I of the Natural Gas Policy Act (DOE/EIA-0448, June 1984), does contain information on natural gas production volumes through 1982 for gas wells drilled after February 1977. These are wells that produce "new" gas, most of which has been decontrolled. These data appear in Attachment 1 for the years 1979 through 1982.

The data in the table are production volumes under NGPA Sections 102, 103, 107, and 108. Producers are not required to file for gas produced under Sections 104, 105, and 106. Between 1979 and 1982, the total natural gas volume produced under these incentive price categories has grown at an average annual rate of 40 percent. Gas produced under any section or subsection increased by at least 27 percent annually during this period, with the sole exception of Section 108, stripper, gas.

These figures are estimated from a compilation of various data sources, including Dwight's Energydata, FERC Form 121 filings and the American Petroleum Institute's Well Data System. Estimation is required as these data are not collected directly. An update to this report is being conducted currently. The updated report will include revised data through 1982 as well as additional data through 1984 and possibly 1985.

Data on prices are presented in Attachment 2. This table displays the median price (in current dollars per thousand cubic feet) and number of wells in each category with valid price information. These data are summarized by the year of the contract as recorded on the Form 121 filing with FERC. The prices listed are initial prices for these contracts. The table shows that generally the median price was highest for the 1982 contract gas. However, the median price for deep gas rose 119 percent for 1980 contracts from the 1979 level. The median price for deep gas attained its maximum with the 1981 contracts and has declined consistently thereafter at an average annual rate of 20 percent.

Attachment 3 presents a table for median contract price (in current dollars per thousand cubic feet) and number of Section 108 (stripper) wells with valid price information. These data are grouped by the report year, the year that FERC received the Form 121. A well qualifies for stripper (Section 108) status by reaching low production levels, 60 mcf per day or less. Wells may produce at such low levels throughout their production life or may convert to stripper levels as flow rates decline over time. It is due to the latter consideration that the report year is the most relevant period for consideration of stripper wells. The data does exhibit an interesting pattern over time. The median contract price has risen consistently over time despite the declining prices of other gas since 1981.

Attachment 1

Production of Natural Gas by NGPA
Incentive Price Category
(Volumes in Billion Cubic Feet)

NGPA CATEGORY	YEAR			
	1979	1980	1981	1982
102 Onshore	811	1532	2577	3182
102 OCS	597	1178	1768	2033
103	1736	2598	3324	3588
107 Deep	221	344	577	755
107 Other	21	97	259	497
108	425	456	448	424
Total	3811	6205	8953	10479

Source: Drilling and Production Under Title I of the Natural Gas Policy Act, DOE/EIA-0448, June 1984.

Attachment 2

edian Contract Price by Section-Category and Contract Year

14:28 THURSDAY, MAY 29, 1986

NGPA Section-Category		Contract Year						
		1979	1980	1981	1982	1983	1984	1985
New Onshore	Contract Price	$2.69	$2.93	$3.18	$3.39	$3.20	$3.00	$2.65
	Number of Wells	4,648	4,440	4,373	3,546	2,644	1,578	309
New OCS Lease	Contract Price	$2.56	$3.01	$3.10	$3.28	$3.00	$2.85	NA
	Number of Wells	69	100	79	38	27	1	NA
New Reservoir on Old OCS Lease	Contract Price	$2.70	$3.01	$3.23	$3.26	$3.61	$3.00	$2.90
	Number of Wells	221	298	210	101	97	27	5
New Onshore Production Well	Contract Price	$2.37	$2.51	$2.65	$2.81	$2.83	$2.89	$2.60
	Number of Wells	7,929	6,231	5,278	3,575	2,592	2,439	615
Deep Gas (Deeper than 15000 ft)	Contract Price	$2.85	$6.24	$6.41	$5.54	$3.47	$3.00	$2.62
	Number of Wells	111	123	143	120	33	28	7
Gas Produced from Devonian Shale	Contract Price	$3.09	$2.81	$5.22	$5.30	$5.37	$5.23	$5.93
	Number of Wells	315	703	328	556	105	130	5
Production Enhancement	Contract Price	$1.63	$0.70	$1.61	$0.53	$2.31	$2.46	$2.00
	Number of Wells	13	13	29	47	12	13	17
New Tight Formation	Contract Price	$4.78	$4.63	$5.01	$4.57	$3.61	$3.40	$3.19
	Number of Wells	1,977	3,170	3,472	1,977	1,329	568	125

rices are in current dollars per thousand cubic feet.
rices for Enhanced Production gas equal to $0.00 were dropped.
ll other prices less than $1.00 were dropped.
ource: Titlel Database.

Attachment 3

Median Contract Price for Stripper Wells By Report Year

14:40 THURSDAY, MAY 29, 1986

		Report Year						
		1979	1980	1981	1982	1983	1984	1985
SECTCAT2								
Stripper Wells	Contract Price	$2.26	$2.28	$2.86	$3.18	$3.57	$3.69	$3.91
	Number of Wells	9,081	12,075	5,415	4,427	3,973	3,172	2,361

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*Prices are in current dollars per thousand cubic feet.
Report Year represents the year that FERC received the Form 121.
Prices less than $1.00 were dropped.
Source: Titlel Database.

JAMES A. McCLURE, IDAHO, CHAIRMAN

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510

June 3, 1986

The Honorable John S. Herrington
Secretary of Energy
Department of Energy
Washington, D.C. 20585

Dear Mr. Secretary:

The following question is in follow-up to your appearance before the Committee on Energy and Natural Resources' May 20, 1986, legislative hearing on S. 834, S. 1251, S. 1302, S. 2205 and S. 2285.

I would like to thank you for your appearance before the Committee and request that you return your reponse to this question by the close of business Friday, June 6, 1986. Your cooperation is greatly appreciated.

Sincerely,

Jim McClure

James A. McClure
Chairman

McC:dar

ADDITIONAL QUESTION FOR SECRETARY HERRINGTON
FROM SENATOR METZENBAUM

For each major interstate pipeline, please provide a listing showing the amount of gas flowing in each NGPA subcategory, the price at which that gas is flowing, for each of the 20 largest integrated producers and the 10 largest independent producers.

Committee Note.--Due to the length of the submission it has been retained in Committee files.

Senator Nickles. We will go to our next panel, if they will all come forward, please.

To all of our panelists, we appreciate your patience. I think it was necessary for both myself and Senator Bumpers and others to ask the Secretary several questions concerning the administration's bill. I also know all of you and I appreciate the fact that many of you have been before our committee in the past.

We do ask, if all of you could summarize your statements, that would help us. We are on the floor. Actually, I have an amendment on the floor, so it may be necessary for me to leave in the near future. Plus I have a markup in another committee. That is one of the reasons several of the Senators are not here.

Not only are the Labor Committee but several other committees engaged in markups this morning, so that is one reason that the attendance is not so high.

But if it would be possible for all of you to summarize your statements and keep your remarks within 3 to 5 minutes, it would certainly be appreciated by this Senator.

Mr. Bush.

STATEMENT OF NICHOLAS J. BUSH, PRESIDENT, NATURAL GAS SUPPLY ASSOCIATION

Mr. Bush. Mr. Chairman, I am Nicholas J. Bush. I am president of the Natural Gas Supply Association, an organization that represents domestic producers of natural gas.

With your permission, Mr. Chairman, I would ask that the association's complete testimony be entered into the record and I will summarize our remarks.

Senator Nickles. Thank you.

Mr. Bush. We appreciate this opportunity to comment on bills pending before the Senate that would alter current natural gas policy. So much has changed in energy production, development, and marketing, particularly so in natural gas, that care should be taken to ensure that proposed legislative changes will address real issues and to the extent possible will address all the problems impeding the adoption of sound economic and energy policies.

NGSA supports the total deregulation of natural gas at the wellhead. Some continue to oppose such action, although, in light of the Nation's experience with partial deregulation, it is difficult to understand their reasons for doing so.

Others contend, like they did prior to partial deregulation, that removal of price controls must be accompanied by abrogation of producer contracts to avoid a price fly-up or significant negative impacts on the finances of interstate pipelines.

Neither contention is true. Both are fairly transparent arguments to continue, if not increase, current subsidies and to provide a generic government bailout from potential individual problems with contractual obligations that are being resolved currently in ongoing renegotiations.

Some people argue that total deregulation of natural gas is less important because of rapidly falling wellhead prices. To believe so, however, is to fail to understand the pervasive and pernicious effects of the disparate inventory costs of major interstate pipelines and the significant loss of future potential domestic gas reserves that results from continued price controls.

Remaining wellhead price controls should simply be removed. There is ample evidence that to do so would be very much in the Nations interest. In fact, I would strongly urge the committee to review the Energy Information Administration's recent analysis that Secretary Herrington referred to, which concludes that natural gas deregulation will mean lower consumer prices and the eventual recovery of an additional 28 trillion cubic feet of domestic reserves. In a future of almost certain increased reliance on imported oil, the importance of encouraging recovery of all economic domestic gas reserves is apparent.

There are those who state that the Federal Energy Regulatory Commission in issuing orders 436 and 436A has done all that is necessary to address natural gas transportation and that Congress need not include a contract carriage provision in the legislation.

While the Commission is to be commended for its efforts to encourage voluntary nondiscriminatory transportation, most interstate pipelines are not participating in implementing orders 436 or 436A. Moreover, there is considerable evidence that some pipelines may intend to design around the principles of these orders in current closed door rate settlement conferences, locking in transportation capacity for their traditional distributor customers and locking out producers, end users, and other willing potential shippers.

A strong contract carriage provision in the legislation is still very much needed. Such a provision, however, no longer needs to be a lengthy, detailed design for nondiscriminatory transportation. What is needed is a provision that empowers the Commission to require pipelines to comply with the principles of orders 436 and 436A.

NGSA also supports repeal of the Fuel Use Act and of the incremental pricing provisions of the NGPA. There are efforts to pass such legislation, we are aware, without provisions that would address deregulation of transportation and other related issues. Repeal of the Fuel Use Act would be helpful. It will increase natural gas sales somewhat, not nearly as much as perhaps some claim, but it would be a plus.

It's difficult to argue, and especially for us, about what may be achievable in the current session of Congress. But I think you will understand, Senator, that it is extremely disappointing for producers, end users, and others who supported deregulation, increased access and more competition in transportation and marketing to be constantly caught in this catch-22 situation, that when prices are going up we are told that a comprehensive deregulation bill is impossible politically and that when prices go down it is either still impossible or not as important.

NGSA and numerous other businesses, industrial and consumer organizations support a comprehensive natural gas bill and would encourage its consideration. We strongly support and prefer S. 2285. We support S. 1302, but would like to see it broadened.

We support S. 1251 and S. 2205, but strongly urge that they be incorporated into legislation that addresses all important gas issues.

Again, thanks, Mr. Chairman, for this opportunity and for your leadership that you have shown in encouraging the frequent review of this policy.

[The prepared statement of Mr. Bush follows:]

TESTIMONY

OF

NICHOLAS J. BUSH

PRESIDENT

NATURAL GAS SUPPLY ASSOCIATION
(NGSA)

BEFORE THE

UNITED STATES SENATE

COMMITTEE ON ENERGY & NATURAL RESOURCES

ON

TUESDAY, MAY 20, 1986

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, MY NAME IS NICHOLAS J. BUSH. I AM THE PRESIDENT OF THE NATURAL GAS SUPPLY ASSOCIATION (N-G-S-A). N-G-S-A IS A NATIONAL ORGANIZATION WHICH REPRESENTS DOMESTIC PRODUCERS OF NATURAL GAS ON LEGISLATIVE AND REGULATORY ISSUES AT THE FEDERAL LEVEL. THE INDEPENDENT AND MAJOR NATURAL GAS PRODUCTION COMPANIES WHICH ARE MEMBERS OF N-G-S-A MARKET ROUGHLY NINETY PERCENT OF AMERICA'S NATURAL GAS PRODUCTION.

N-G-S-A'S MEMBERS ARE COMMITTED TO THE CONCEPT OF FREEING NATURAL GAS MARKETS, AT THE WELLHEAD AND AT THE BURNERTIP, FROM GOVERNMENT INTERFERENCE IN THE FORM OF FEDERAL REGULATION. DURING THE PAST FORTY YEARS THE NATURAL GAS INDUSTRY HAS BEEN SUBJECTED TO CONSIDERABLE POLITICAL TINKERING TO ESTABLISH OR PRESERVE ECONOMIC BENEFITS FOR CERTAIN INTEREST GROUPS. REGIONAL POLITICAL CONSIDERATIONS HAVE DOMINATED OVER SOUND POLICY DECISIONS BASED ON THE

PRINCIPLES OF SUPPLY AND DEMAND. EVEN TODAY, CONTINUING GOVERNMENT REGULATION OF NATURAL GAS PRIMARILY BENEFITS A SMALL GROUP OF CONSUMERS AT THE EXPENSE OF THE LARGER GROUP OF BOTH RESIDENTIAL AND INDUSTRIAL CONSUMERS AND THE ECONOMY AS A WHOLE.

NO SEGMENT OF THE ENERGY INDUSTRY HAS SUFFERED MORE FROM NATIONAL ENERGY AND ECONOMIC POLICIES BASED ON FLAWED POLITICAL ASSUMPTIONS, THAN HAS THE NATURAL GAS INDUSTRY. AFTER NEARLY A HALF CENTURY OF PRICE CONTROLS AND TIGHT REGULATIONS OVER INTERSTATE GAS SUPPLIES AND SALES, IN THE LATE SEVENTIES THE NATION EXPERIENCED SEVERE NATURAL GAS SHORTAGES. THE HISTORICAL PROMISE HELD OUT TO CONSUMERS THAT NATURAL GAS SUPPLIES WOULD ALWAYS BE PLENTIFUL AND CHEAP IF PRICES WERE CLOSELY REGULATED, WAS PROVEN TO BE A CRUEL HOAX.

INDEED, IN A STUDY RELEASED IN FEBRUARY OF THIS YEAR, THE ENERGY INFORMATION ADMINISTRATION (E-I-A) STATES THAT PRIOR TO PASSAGE OF THE NATURAL GAS POLICY ACT IN 1978 (N-G-P-A), "THE YEARS OF WELLHEAD REGULATION HAD RESULTED IN INDUSTRY CHAOS: SHORTAGES OF SUPPLY IN THE REGULATED INTERSTATE MARKET, SURPLUS IN THE UNREGULATED INTRASTATE

MARKET, AND PRICES THAT HAD NO RELATION TO THE CURRENT MARKET VALUE OF NATURAL GAS."*

THE NATURAL GAS POLICY ACT REPRESENTED A NECESSARILY DIFFICULT COMPROMISE. BY CREATING MANY NEW DISTORTIONS IN GAS MARKETS THAT HAVE BEEN HARMFUL IN RECENT YEARS, THE N-G-P-A CONTINUED MANY OF THE FLAWED POLICIES OF THE PAST. BUT THE N-G-P-A DID PROVIDE FOR THE PARTIAL DEREGULATION OF NATURAL GAS AT THE WELLHEAD ON JANUARY 1, 1985. PARTIAL DEREGULATION, COUPLED WITH RECENT FALLING OIL PRICES, SET IN MOTION A COMPETITIVE ENVIRONMENT IN THE NATURAL GAS INDUSTRY WHICH HAS SPREAD AND INTENSIFIED SINCE JANUARY OF LAST YEAR.

SPOT MARKET PRICES FOR NATURAL GAS AT THE WELLHEAD HAVE FALLEN STEADILY SINCE SEPTEMBER, 1984. THOSE WHO OPPOSE THE LOGICAL FINAL STEP OF REMOVING THE REMAINING WELLHEAD CONTROLS EXHIBIT A FUNDAMENTAL DISTRUST OF MARKET MECHANISMS AS WELL AS A SHORT-SIGHTED VIEW OF THE PUBLIC INTEREST. IN THE E-I-A REPORT WHICH I CITED EARLIER, IT IS NOTED THAT

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* "AN ANALYSIS OF NATURAL GAS CONTRACTS," ENERGY INFORMATION ADMINISTRATION (VOL. I, FEBRUARY 1986).

ALTERNATING PERIODS OF SURPLUS AND SHORTAGE HAVE BEEN MET BY COUNTERPRODUCTIVE F-E-R-C REGULATIONS "CAUSING DISORDERS OF ONE KIND IN TIMES OF SURPLUS AND DISORDERS OF ANOTHER KIND IN TIMES OF SHORTAGE. FEDERAL POLICY HAS SHIFTED ACCORDINGLY, BUT TO DATE UNSUCCESSFULLY."*

OPPONENTS OF COMPLETE WELLHEAD DEREGULATION WANT TO MAINTAIN THE CUMBERSOME AND BUREAUCRATIC REGULATORY REGIME WHICH THEY BELIEVE IS APPROPRIATE TO CURRENT CONDITIONS OF SURPLUS, WITHOUT REGARD TO THE NEEDS OF A HEALTHY ENERGY INDUSTRY, OR FOR SECURE NATURAL GAS SUPPLIES. ALTHOUGH PURPORTEDLY CLAIMING TO SUPPORT THE INTERESTS OF CONSUMERS, OPPONENTS OF DEREGULATION WOULD, IN FACT, DENY CONSUMERS THE SIGNIFICANT BENEFITS WHICH WOULD ACCRUE FROM A COMPETITIVE AND ECONOMICALLY RATIONAL PRICING STRUCTURE.

N-G-S-A STRONGLY SUPPORTS THE COMPLETE DEREGULATION OF ALL NATURAL GAS SUPPLIES AT THE WELLHEAD. N-G-S-A ALSO FAVORS LEGISLATIVE PROVISIONS WHICH WILL SERVE TO PERMIT PRODUCERS AND CONSUMERS TO PROCURE TRANSPORTATION OF NATURAL

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* _ID._ AT 33.

GAS ON A NON-DISCRIMINATORY BASIS. N-G-S-A HAS ALWAYS OPPOSED RESTRICTIONS ON NATURAL GAS USE, AND, THEREFORE, STRONGLY SUPPORTS LEGISLATION REPEALING THE FUEL USE ACT AND INCREMENTAL PRICING PROVISIONS OF THE N-G-P-A.

TODAY WE FACE THE INEVITABLE CONSEQUENCE OF A MASSIVE DOWNTURN IN EXPLORATION AND DRILLING FOR NEW RESERVES. N-G-S-A HAS DETAILED DECLINING DRILLING LEVELS BEFORE THE ENERGY REGULATION & CONSERVATION SUBCOMMITTEE OF THIS COMMITTEE IN PRIOR TESTIMONY ON NOVEMBER 21 AND SEPTEMBER 19, 1985. THE MOST RECENT REPORTS INDICATE THAT THE CURRENT RIG COUNT IS NOW AT ITS LOWEST LEVEL SINCE WORLD WAR II. THE SLIGHTLY MORE THAN 800 RIGS IN OPERATION TODAY REPRESENTS A DECLINE IN EXCESS OF 50 PERCENT FROM LAST YEAR'S NUMBERS.

WITH THE CONTINUING INSTABILITY IN INTERNATIONAL ENERGY PRICES THE PROSPECTS FOR DISCOVERY AND DEVELOPMENT OF NEW AND EXISTING RESERVES HAVE DIMINISHED SIGNIFICANTLY. IT IS THEREFORE IMPERATIVE THAT IMPEDIMENTS TO DEVELOPMENT OF LEAST COST RESERVES AND THE MARKETING OF THOSE RESERVES BE REMOVED.

A QUICK OR A PARTIAL FIX WILL NOT SERVE THE BEST INTERESTS OF THE INDUSTRY OR CONSUMERS. NOW IS THE TIME FOR

THE FEDERAL GOVERNMENT TO FULLY WITHDRAW FROM THE BUSINESS OF REGULATING NATURAL GAS PRODUCERS. A SIGNAL NEEDS TO BE SENT TO ALL SEGMENTS OF THE INDUSTRY -- PRODUCERS, PIPELINES, DISTRIBUTORS AND CONSUMERS ALIKE -- THAT A FREE MARKET AND PRIVATE NEGOTIATIONS THEREIN REPRESENT THE BEST TOOLS FOR ACHIEVING A REASONABLE BALANCE IN SUPPLY AND DEMAND AT A FAIR PRICE.

OF COURSE, A BALANCE IN SUPPLY AND DEMAND CANNOT BE EXPECTED UNTIL ACCESS TO SUPPLIES IS PROVIDED ON A NON-DISCRIMINATORY BASIS FOR ALL CONSUMERS. N-G-S-A STRONGLY FAVORS TRANSPORTATION (CONTRACT CARRIAGE) BY PIPELINES OF NATURAL GAS FOR OTHERS. DUE TO THE RELUCTANCE OF MANY INTERSTATE PIPELINES TO PARTICIPATE IN F-E-R-C'S RECENT ORDER 435, THE ABILITY OF BOTH CONSUMERS AND PRODUCERS TO TRANSPORT NATURAL GAS HAS BEEN SEVERELY HAMPERED. F-E-R-C CANNOT PRESENTLY MANDATE THAT INTERSTATE PIPELINES MUST PROVIDE NON-DISCRIMINATORY CONTRACT CARRIAGE. LEGISLATION EMPOWERING THE COMMISSION TO IMPLEMENT THE GOALS OF ORDER 436, SUCH AS THAT SET FORTH IN THE D-O-E BILL, S. 2285, WOULD PROVIDE ACCESS TO NATURAL GAS RESOURCES ON A NON-DISCRIMINATORY BASIS.

IN ADDITION TO OUR SUPPORT FOR REPEAL OF THE FUEL USE ACT AND INCREMENTAL PRICING PROVISIONS OF THE N-G-P-A, WE ENDORSE THE NATIONAL DEFENSE COUNCIL'S OPPOSITION TO A CONGRESSIONAL PROHIBITION ON THE DEPARTMENT OF DEFENSE USING NATURAL GAS IN NEW, LARGE HEATING SYSTEMS ON MILITARY INSTALLATIONS WITHIN THE CONTINENTAL UNITED STATES, REGARDLESS OF THE COST OR ENVIRONMENTAL BENEFITS OF USING GAS.

MR. CHAIRMAN, AT A HEARING LAST MONTH BEFORE THE ENERGY REGULATION & CONSERVATION SUBCOMMITTEE, DISTRIBUTORS AND PIPELINES ANNOUNCED THEIR WILLINGNESS TO ENDORSE PHASED DEREGULATION OF OLD GAS, SIMILAR TO THE APPROACH IN SENATOR NICKLES' LEGISLATION, S. 1302, IN RETURN FOR INSERTION OF A MARKET-OUT OR ECONOMIC REDETERMINATION CLAUSE -- CALL IT WHAT YOU WILL -- IN ALL CONTRACTS WHICH THEY DESCRIBE AS NON-MARKET RESPONSIVE. WHILE PIPELINES SEEM TO BE INCREASINGLY RELIANT UPON THE MARKET-OUT MECHANISM AS A MARGIN ENHANCEMENT TOOL, CONGRESSIONAL ENDORSEMENT OF A UNILATERAL ABROGATION OF CONTRACT TERMS WOULD UNDOUBTEDLY RESULT IN NEW MARKET DISTORTIONS.

WHAT THE A-G-A PROPOSAL WOULD DO IS REQUIRE THAT CONTRACT SANCTITY BE HONORED FOR THOSE CONTRACTS REGULATED AT PRICES WELL BELOW THE MARKET, FREEING SOME OF THAT GAS AT A RATE OF ABOUT 8 TO 9 PERCENT PER YEAR, WHILE IN RETURN GIVING PIPELINES THE ABILITY TO UNILATERALLY ABROGATE IMMEDIATELY ALL CONTRACTS WHICH ARE CONSIDERED ABOVE WHAT THEY DEFINE AS MARKET. THE REVENUE IMPACT IF SUCH A PROPOSAL WERE ADOPTED WOULD BE ENORMOUS FOR THE DOMESTIC PRODUCING INDUSTRY WHICH IS ALREADY SUFFERING FROM SERIOUS PROBLEMS. THE IMPACT UPON GAS SUPPLIES WOULD ALSO BE VERY NEGATIVE.

MR. CHAIRMAN, I WOULD LIKE TO ADDRESS THIS CONTRACT ABROGATION ISSUE WHICH HAS GENERATED CONSIDERABLE DEBATE OVER THE COURSE OF THE PAST FOUR YEARS. IN CURRENT PROCEEDINGS BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION (F-E-R-C), SOME PIPELINES AND DISTRIBUTORS ARE ARGUING THAT A SERIOUS PROBLEM IS BREWING IN THE FORM OF PIPELINE CONTRACTUAL TAKE-OR-PAY OBLIGATIONS. IN F-E-R-C DOCKET NO. RM86-3-000, N-G-S-A HAS SUBMITTED TWO SETS OF COMMENTS WHICH WERE ATTACHED AS APPENDICES A & B TO N-G-S-A'S TESTIMONY PRESENTED AT THE APRIL 15, 1986 ENERGY REGULATION & CONSERVATION SUBCOMMITTEE PROCEEDINGS. N-G-S-A'S COMMENTS IN APPENDIX B

INCLUDED SEVERAL DETAILED STUDIES OF THE TAKE-OR-PAY ISSUE IN RESPONSE TO THE SPECTRE OF IMPENDING DISASTER RAISED BY INTERSTATE PIPELINES OSTENSIBLY DUE TO TAKE-OR-PAY CONTRACT CLAUSES.

A CLOSE EXAMINATION OF THIS ISSUE IN A STUDY CONDUCTED FOR N-G-S-A BY FOSTER ASSOCIATES IN 1984, REVEALED THAT THERE WAS NO WIDESPREAD TAKE-OR-PAY PROBLEM PLAGUING THE ENTIRE INTERSTATE PIPELINE SYSTEM, AND CERTAINLY NO PROBLEM THAT COULD NOT BE SETTLED BY PRIVATE PARTY NEGOTIATIONS.* THIS STUDY DEMONSTRATED THAT THE "PROBLEM" TAKE-OR-PAY LIABILITIES WERE CENTERED ON ONLY FOUR OUT OF THIRTY-SIX MAJOR INTERSTATE PIPELINES.

TODAY, MANY PIPELINES ARGUE THAT "POTENTIAL" TAKE-OR-PAY LIABILITIES SOMEHOW CREATE A JUSTIFICATION FOR NOT BECOMING NON-DISCRIMINATORY TRANSPORTERS. A CAMPAIGN IS BEING CONDUCTED TO CONVINCE POLICY-MAKERS THAT TAKE-OR-PAY LIABILITIES, AND THE ALLEGED LACK OF RELIEF FROM PRODUCERS ON

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* SEE ANALYSIS OF THE TAKE-OR-PAY PROBLEM, FOSTER ASSOCIATES, INC., PREPARED FOR THE NATURAL GAS SUPPLY ASSOCIATION, MARCH 1984, AT 3 - 4.

SUCH CONTRACT CLAUSES, CAUSED SUCH A PROBLEM THAT LEGISLATIVE OR REGULATORY RELIEF IS NEEDED.

DOCUMENTED EVIDENCE SUCH AS THAT IN APPENDIX B AND THE ATTACHMENTS THERETO, SHOWS THAT THESE CLAIMS ARE GENERALLY FALSE. AT THE APRIL 15 HEARINGS, DICK NELSON ON BEHALF OF N-G-S-A TESTIFIED THAT FACTUAL, OBJECTIVE DATA DEMONSTRATES THAT PRODUCERS HAVE GRANTED INTERSTATE PIPELINES SUBSTANTIAL TAKE-OR-PAY AND OTHER CONTRACT RELIEF AND, IN THEIR OWN INTEREST, WILL DO SO IN THE FUTURE TO SUSTAIN SALES.

DOCUMENTS FILED BY THE PIPELINES WITH THE F-E-R-C AND COMMENTS MADE BY REPRESENTATIVES OF THE PIPELINES BEFORE CONGRESSIONAL COMMITTEES AND IN THE PRESS DEMONSTRATE THAT MULTIPLE AND OFTEN CONTRADICTORY MESSAGES ARE BEING DELIVERED ON THE ISSUE OF CONTRACTUAL DISPUTES AND PARTICULARLY TAKE-OR-PAY SETTLEMENTS: TO THE FINANCIAL INDUSTRY THESE ISSUES ARE REPRESENTED AS WORKABLE; TO POLICY-MAKERS IT IS ARGUED BY THE PIPELINES THAT DISASTER IS IMMINENT.

IT SHOULD BE NOTED THAT PIPELINES HAVE NOT SUFFERED FINANCIALLY FROM THE TAKE-OR-PAY "ISSUE" AS EVIDENCED BY THE FACT THAT THE AVERAGE RETURN ON COMMON EQUITY FOR TWENTY-FIVE

MAJOR INTERSTATE PIPELINES GREW FROM 14.12 PERCENT IN 1981 TO 16.89 PERCENT IN 1984 (RECALL THAT INTERSTATE PIPELINES ARE REGULATED MONOPOLIES). FURTHERMORE, PIPELINE COMPANY ANNUAL REPORTS NOTE THAT THIS SEGMENT OF THE INDUSTRY GENERALLY EXPECTS FULL RECOVERY OF ANY TAKE-OR-PAY PAYMENTS BY PASSING ON SUCH COSTS TO CONSUMERS. MOREOVER, THE ACTUAL COST OF TAKE-OR-PAY SETTLEMENTS ARE A SMALL FRACTION OF THE TOTAL LIABILITIES BEING PUBLICLY CLAIMED. (SEE APPENDIX B TO N-G-S-A APRIL 15, 1986 TESTIMONY BEFORE ENERGY REGULATION & CONSERVATION SUBCOMMITTEE.)

DURING HEARINGS BEFORE THE HOUSE FOSSIL & SYNTHETIC FUELS SUBCOMMITTEE ON NOVEMBER 13 AND 14 OF LAST YEAR, PRODUCER WITNESSES FROM N-G-S-A MEMBER COMPANIES EXXON AND CONOCO TESTIFIED THAT IN MANY CONTRACTS, TAKE-OR-PAY FUNDS FOR GAS ARE PUT INTO A SPECIAL ACCOUNT; PRODUCERS CANNOT "BOOK" THOSE MONIES UNTIL SUCH TIME AS THE GAS IS ACTUALLY TAKEN. THESE WITNESSES ALSO TESTIFIED THAT IF THE GAS IS NEVER TAKEN, THE FUNDS, AFTER A PERIOD OF TIME (GENERALLY FIVE YEARS), ARE RETURNED TO THE PIPELINE. THE PIPELINES' LOSS OF THE TIME VALUE OF SUCH FUNDS IS ESSENTIALLY A PAYMENT

TO PRODUCERS FOR THE STORAGE OF THE GAS ON BEHALF OF THE PIPELINE.

SUMMARIZING THE CONSIDERABLE TESTIMONY BEFORE F-E-R-C AND BEFORE CONGRESSIONAL COMMITTEES, AND THE DATA CITED IN THOSE MATERIALS, IT IS FAIR TO SAY THAT THERE HAS BEEN A HIGH LEVEL OF TAKE-OR-PAY RENEGOTIATION. N-G-S-A CONDUCTED A SURVEY OF SEVERAL MEMBER COMPANIES (AMOCO, ARCO, ASHLAND, CHEVRON, CONOCO, EXXON, MARATHON, MOBIL, PHILLIPS, SHELL, SUN, TEXACO, CHAMPLIN, CITIES SERVICE, UNOCAL), TO DETERMINE THE AMOUNT OF TAKE-OR-PAY LIABILITIES SETTLED DURING THE PERIOD 1981 - 1985. THE RESULTS OF THIS SURVEY SHOW THAT SETTLEMENTS HAVE OUTPACED NEW LIABILITIES BY A 2 TO 1 RATIO AND THAT MOST OF THE REMAINING POTENTIAL LIABILITY IS OF RECENT ORIGIN. DURING THIS PERIOD, N-G-S-A'S MEMBERS HAVE SETTLED $5.7 BILLION, OR 70 PERCENT, OF ACCUMULATED PIPELINE TAKE-OR-PAY LIABILITIES OF $8.5 BILLION. THE REMAINING AMOUNT IS OF RECENT (1985) ORIGIN.

AS I STATED EARLIER, NOW IS THE TIME TO GET THE GOVERNMENT OUT OF NATURAL GAS WELLHEAD REGULATION. THE NATURAL GAS INDUSTRY AND ALL NATURAL GAS CONSUMERS WILL

BENEFIT IMMENSELY BY SUCH ACTION. COMPREHENSIVE NATURAL GAS LEGISLATION SUCH AS S. 2285, THE D-O-E DECONTROL BILL, IS CERTAINLY THE APPROPRIATE APPROACH TO THESE PROBLEMS.

THANK YOU FOR THIS OPPORTUNITY TO APPEAR AND PRESENT THE VIEWS OF THE NATURAL GAS SUPPLY ASSOCIATION. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS WHICH YOU MAY HAVE.

Senator NICKLES. Mr. Bush, thank you very much.

Our next panelist is Brian O'Neill, president of the Transcontinental Gas Pipe Line, from Houston, TX. Mr. O'Neill.

STATEMENT OF BRIAN E. O'NEILL, PRESIDENT, TRANSCONTINENTAL GAS PIPE LINE CORP., ON BEHALF OF INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, ACCOMPANIED BY KEITH E. BAILEY, PRESIDENT, NORTHWEST CENTRAL PIPELINE CORP.

Mr. O'NEILL. Thank you, Mr. Chairman.

I am a member of the executive committee of INGAA, which is the Interstate Natural Gas Association of America. I am accompanied today by Mr. Keith Bailey, who is president of Northwest Central Pipeline Co.

I appreciate the opportunity to appear before you today on behalf of INGAA. Just briefly summarized, INGAA's position is that high priced, high take or pay pipeline-producer contracts for gas continue to create serious problems for the industry.

By and large, the problem contracts have not yet been renegotiated. By INGAA's estimates, take-or-pay exposure will range between $12 and $16 billion by the end of 1986. Further, 38 percent of the gas flowing in interstate commerce, including about one-fourth of the old gas, is priced well above market levels and is not responsive to market pressures.

Meaningful legislation must provide incentives to encourage renegotiation so that gas markets can function successfully.

INGAA is opposed to the administration proposal, S. 2285, because it is extremely one sided. It provides almost immediate legislative relief for low gas prices, but in no way addresses the high price, high take or pay contracts with producers that are the primary problem facing the industry today.

Third, INGAA would support the decontrol of old gas as contracts expire or are renegotiated, as provided for in your bill, S. 1302, provided the legislation also addresses the nonmarket responsive contracts problem.

And last, if comprehensive legislation is not possible, INGAA does believe that the repeal of the demand constraints imposed by the Fuel Use Act and incremental pricing should move forward separately.

Take-or-pay is clearly a widespread industry problem, and it is not limited to just a few problems. INGAA's own survey data indicates a current take-or-pay exposure of as much as $9.4 billion for 80 percent of the interstate market. By year end 1986, INGAA estimates that the take-or-pay exposure for its member companies could grow to between $12 and $16 billion if contract renegotiations are not successful.

The fall in wellhead prices being paid for new contracts continues to aggravate the problem of inflexible pipeline-producer purchase agreements priced far above what today's market can accept. The focal point of the marketplace is spot gas, which currently in some producing areas is below $1 per MMBtu. By comparison, the most recent reported weighted average cost of gas on interstate pipelines is $2.31 per million Btu's.

Twenty-four percent of our purchases is for new gas, estimated at $4.39 per million Btu's on average—obviously not responsive to market conditions. Substantial volumes of old gas are also well above market-clearing levels.

Now, the interstate market is faced with about 38 percent on average of its actual purchases priced above market clearing levels. This includes both certain volumes of old gas and nonmarket responsive new gas. The problem contracts for both low and high prices must be resolved simultaneously.

You cannot raise old gas prices without providing a mechanism for lowering high gas prices. INGAA strongly believes that balanced legislation addressing these problem areas is sorely needed.

The administration's bill would decontrol all gas as of April 1, 1987, an event that would release tremendous upward pressure of average natural gas prices at a time when the industry is already struggling to reduce costs in order to hold onto market share in the face of plummeting oil prices. Incredibly, the bill contains absolutely no provision even to assist in the renegotiation of high price, high take contracts.

Again, as I said, we do support Senate 1302, providing we can get a mechanism to help with that renegotiation. If comprehensive legislation is not possible in this session of the Congress, we strongly urge legislation repealing the gas use limitations of the Fuel Use Act and title II of the NGPA.

That concludes my statement, Mr. Chairman.

[The prepared statement of Mr. O'Neill follows:]

STATEMENT OF
BRIAN E. O'NEILL
PRESIDENT, TRANSCONTINENTAL GAS PIPE LINE CORPORATION
ON BEHALF OF THE
INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
MAY 20, 1986

Mr. Chairman and Members of the Committee:

I am Brian O'Neill, President and Chief Operating Officer of Transcontinental Gas Pipe Line Corporation, and a member of the Interstate Natural Gas Association of America (INGAA) Executive Committee. Accompanying me is Mr. Keith Bailey, President, Northwest Central Pipeline Company. I appreciate the opportunity to appear before you today on behalf of INGAA to discuss natural gas legislation and the status of today's natural gas markets.

INGAA is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the United States. Our member companies are both wholesalers and transporters, moving natural gas from producing areas to distributors and end users across the nation. In addition, our members perform other services, including extensive natural gas storage operations and other load balancing functions Approximately 90 percent of the natural gas transported and sold in interstate commerce flows through more than 200,000 miles of pipeline owned and operated by INGAA member companies.

SUMMARY OF POSITION

1. High price, high take-or-pay pipeline/producer contracts for gas continue to create serious problems for the industry. By and large the problem contracts have not yet been renegotiated. By INGAA's estimates, take-or-pay exposure will range between $12-$16 billion by the end of 1986. Further, 38 percent of the gas flowing in interstate commerce (including

about one-fourth of the old gas) is priced well above market levels and is not responsive to market pressures. Meaningful legislation must provide incentives to encourage renegotiation so that gas markets can function successfully.

2. INGAA is opposed to the Administration proposal (S. 2285) because it is extremely one-sided. It provides almost immediate legislative relief for low price gas but in no way addresses the high price, high take-or-pay contracts with producers that are the primary problem facing the industry today.

3. INGAA would support the decontrol of old gas as contracts expire or are renegotiated, as provided for in Senator Nickles' bill S. 1302, provided the legislation also addresses the nonmarket-responsive contracts problem.

4. INGAA strongly supports S. 2205, repealing the gas use limitations embodied in the Fuel Use Act (FUA). INGAA also supports S. 1251, which in addition to repealing the FUA gas use restrictions would also repeal the incremental pricing provisions of Title II of the Natural Gas Policy Act (NGPA). If comprehensive legislation is not possible, INGAA believes repeal of these demand constraints should move forward separately.

THE NEED FOR LEGISLATION

INGAA believes that comprehensive legislation is the best way to address the problems facing the industry. Without legislation the industry will be in limbo while the courts decide whether and to what extent the FERC has exceeded its authority in Order 436 (and in RM86-3, if approved substantially as proposed) and to what extent the Commission has neglected its Natural Gas Act responsibilities. History shows that court review and corrective action by the Commission can take years to complete. This lost time could jeopardize the consumers' long-term supply of gas.

We are also concerned about the deterioration of the exploration and development segment of the industry. Many independent producers have gone out of business, banks supporting the gas industry are in trouble and the major producers are laying off their engineers and geologists. Thus, the very infrastructure required to perpetuate the industry is in jeopardy. If four years is truly the minimum planning horizon required to develop new gas reserves, comprehensive natural gas legislation dealing directly with problem contracts is needed sooner rather than later.

THE PROBLEM OF TAKE-OR-PAY

Some producers would portray the take-or-pay issue as a "red herring," limited in scope and magnitude. The facts demonstrate otherwise. The problem is indeed very serious:

1. It is a problem affecting a broad spectrum of pipeline companies;

2. exposure by year-end 1986 is estimated to range between $12-$16 billion; and

3. although there have been some settlements in the past, the new rules under which the pipelines must now operate make settlement extremely difficult.

The Natural Gas Supply Association (NGSA) has accused INGAA of grossly overstating the seriousness of the take-or-pay problem. In its testimony before the Subcommittee on Energy Regulation and Conservation on April 15, 1986, the NGSA claimed that only four pipelines faced a problem in this regard. Furthermore, it claimed that $5.698 billion of take-or-pay exposure accrued from 1981 through 1985, and that $3.146 billion of this total had been renegotiated.

This data is incomplete and misleading. Moreover, much of the renegotiation referred to took place prior to FERC Orders 380 and 436. Not only does the data understate the magnitude of the take-or-pay problem, but it masks the fact that the problem is growing in severity, not diminishing.

Take-or-pay is clearly a widespread industry problem and is not limited to just a few pipelines. At least 12 companies, representing 16 pipeline systems and over 60 percent of the interstate market, have cited take-or-pay as being a major problem in their current (1985) 10-Ks or annual reports. These companies report take-or-pay exposure at the end of 1985 of $6.1 billion.[1/] (See Table 1.) INGAA's own survey data indicates a current take-or-pay exposure of as much as $9.4 billion for 80 percent of the interstate market.

More significant than this, however, is the rapid rate at which the take-or-pay problem is growing. INGAA's just-completed survey of member companies found that they expect their pipeline exposure to increase by another $6.6 billion in 1986. Thus, by year-end 1986, INGAA estimates the take-or-pay exposure for its member companies will grow to between $12-$16 billion, if contract renegotiations are not successful.

Take-or-pay is growing primarily because of Orders 380 and 436. These orders not only opened the marketplace to competition but also undermined the long-standing sales agreements the pipelines had relied upon in entering into take-or-pay contracts.

These FERC orders permit the pipelines' customers to forego the supplies the pipelines arranged on their behalf. These are the very same customers who projected the need for gas, encouraged the pipelines to acquire the gas at any cost and committed to buy the gas, until FERC changed the rules. In hindsight it is easy to say the pipelines overestimated the market potential, but there is no way our member companies could have anticipated such far-reaching regulatory changes as Orders 380 and 436.

The data makes it abundantly clear that take-or-pay is a multibillion-dollar problem that must be resolved as we move toward open access transportation and try to reconcile outmoded gas prices to market conditions.

Assertions have been made that the problem will solve itself -- that producers, somehow, will agree to renegotiate these take-or-pay and high price contracts. This may have been true at a time last year when pipelines could still offer transportation in exchange for settlement of take-or-pay issues. The fact is, however, that under the new regulatory climate many producers no longer feel any need to renegotiate. They expect to have access to pipeline transportation under Order 436 and thus they feel no compulsion to sit down at the bargaining table.

To help put this into perspective, we have compared the estimated year-end 1985 pipeline take-or-pay exposure to the 1985 revenues and earnings for the major segments of the industry -- integrated petroleum companies, independent oil and gas producers, gas pipelines and gas distributors. (See Table 2, attached.) The comparison shows a large discrepancy in the relative importance of take-or-pay between the different segments of the industry.

The estimated $9.4 billion pipeline exposure as of year-end 1985 represents only 2 percent of the integrated petroleum companies' 1985 revenues ($434 billion) and 50 percent of their 1985 earnings ($18.9 billion). In contrast, the take-or-pay problem represents 24 percent of the pipelines' 1985 revenues ($39 billion) and 348 percent of their earnings ($2.7 billion). This comparison ignores the additional 1986 exposure, forecast to be $6.6 billion.

Given this wide discrepancy in relative impact of take-or-pay on revenues and earnings, it is not difficult to understand why the larger producers are unwilling to accept legislation that would provide incentives for renegotiation.

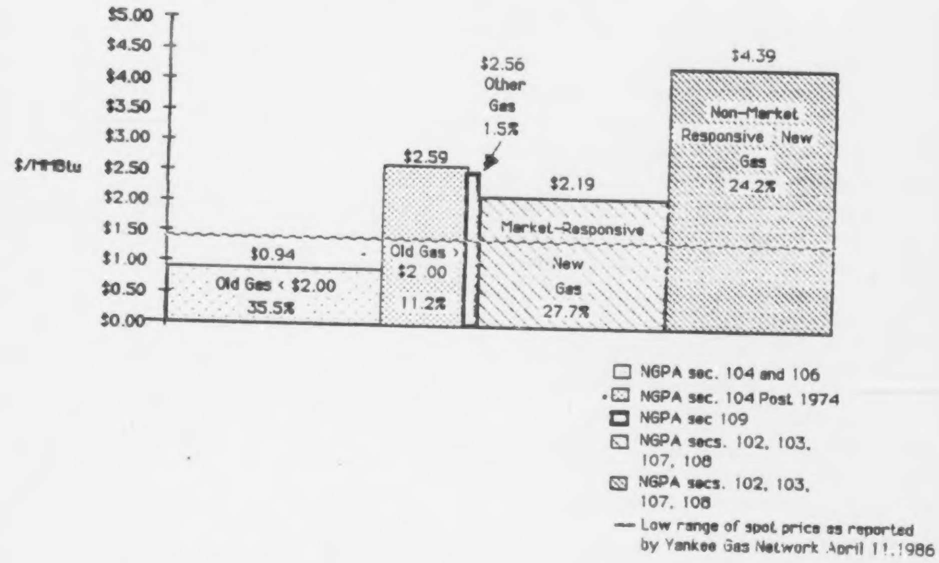
We firmly believe that the take-or-pay and high price contract problem must be addressed in any comprehensive legislation the Congress may consider.

THE PROBLEM OF HIGH PRICE, NONMARKET-RESPONSIVE CONTRACTS

The fall in wellhead prices being paid for new contracts continues to aggravate the problem of inflexible pipeline/producer purchase agreements priced far above what today's market can accept. The focal point of the marketplace is spot gas, which currently, in some producing areas, is below $1.00 per MMBtu. By comparison, the most recent reported weighted average cost of gas (WACOG) of interstate pipelines is $2.31 per MMBtu.2/

The chart following reflects INCAA's best estimates of the price and volume of the gas flowing in interstate markets as of May 13, 1986.

Current Distribution of Gas Prices: 5-13-86



INGAA's member companies report that only about 28 percent of pipeline volumes is new gas purchased pursuant to contracts containing market-responsive terms. We estimate the average price for this gas is currently about $2.19 per MMBtu.[3] Another 24 percent of our purchases is for new gas estimated at $4.39 per MMBtu, on average, obviously not responsive to market conditions.[4] Furthermore, much of the highest cost gas under contract is shut in, thus not reflected in the WACOG average (but which is reflected in escalating take-or-pay exposure).

To further illustrate the problem with high price nonmarket-responsive contracts, attached is a table (Table 3) showing the average prices paid by interstate pipelines to 17 major producers. Although the overall average price paid to these producers is $2.39 per MMBtu, the price paid under new gas contracts (i.e., gas that would fall into Block 2 under the FERC's block billing proposal) averages $3.60 per MMBtu, ranging from a high of $4.28 per MMBtu for Amoco to a low of $3.14 per MMBtu for Phillips. These averages include both market-responsive and nonmarket-responsive new gas contracts, yet the average exceeds current market prices by $1 to $2 per MMBtu. Thus, while many producers would have you believe they have been agreeable to renegotiation, and in fact some renegotiation has taken place, these producers clearly have not yet responded to market pressures. This table should dispel any doubt that high price gas is a critical issue in the natural gas industry today. Despite all the changes in the marketplace, the average price of gas of the vast majority of these producers is well above $2.00 per MMBtu.

There is a widespread impression that all old gas is priced below market levels. Thirty-six (36) percent of pipeline purchases is at an average price of $.94 per MMBtu, a price that is below average spot prices, but higher than some recently reported spot sales. Substantial volumes of old gas are in fact well above market clearing levels.[5] As the chart reflects, 11 percent of pipeline purchases is old gas priced at an average of $2.59 per MMBtu.[6] This regulated price is well above spot prices and is increasing. It is also above the average price of market-responsive new gas, currently $2.19 per MMBtu, which is falling.

On average the interstate market is faced with about 38 percent of its actual purchases priced above market clearing levels; this includes both certain volumes of old gas and nonmarket-responsive new gas (and some 2 percent Section 109 gas). The problem contracts for both low and high prices must be resolved simultaneously -- one part of the problem cannot be fixed without fixing the other. You cannot raise old gas prices without providing a mechanism for lowering high gas prices.

LEGISLATIVE SOLUTIONS

INGAA would prefer to resolve the contract problem without abrogating existing pipeline/producer contracts. A strategy that worked in the past to reduce marketplace distortions involved take-or-release of unmarketable reserves. Under the Special Marketing Programs (SMPs) instituted by the FERC in 1983, pipelines and producers could trade transportation for contract relief and release of reserves. Under the "take-or-release" program, a pipeline released a producer from its sales obligations with the pipeline when the pipeline was unable to fulfill its minimum purchase obligations. In turn, the pipeline agreed to transport the gas for the producer when the producer found a new buyer. The duration of the release varied as well as the quantity released and the terms of the take-or-pay settlement.

This approach was working well prior to the court decision in the Maryland People's Counsel case and Order 436. In fact, it provided $1.3 billion in take-or-pay relief while prices for the gas transported were discounted from 17 to 67 percent, and was not considered contract abrogation by the participants. Significantly, it was not this feature of the program that the court struck down in the Maryland People's Counsel case.

INGAA believes that such an approach could again facilitate the resolution of market disorders if positive renegotiation incentives could be incorporated into legislation. The SMP negotiating environment could be recreated if legislation affirmed that a pipeline could decline to transport the gas of a specific producer should the pipeline be unable to meet its minimum purchase obligations with that producer. Without this provision, comprehensive legislation would deny pipelines the bargaining tools to obtain the necessary contract renegotiation that is fundamental to any comprehensive natural gas legislation that might be enacted.

Recently the AGA has put forward a new proposal for addressing pricing and contract isues. This proposal would decontrol all gas but tie decontrol of new gas to the neutralization of indefinite price escalator (IPE) clauses in new gas contracts, encouraging a renegotiation of such contracts to market levels. As I have stated, INGAA would prefer to avoid contract abrogation, but we believe the AGA approach is a reasonable one, although it is only a partial solution to the dilemma I have outlined because it would not assure the renegotiation of all nonmarket-sensitive contracts. We could support the

AGA recommendation and we urge the Committee and other segments of the industry to consider it carefully.

INGAA strongly believes comprehensive legislation addressing these problem areas is sorely needed. I would like to make clear, however, that in the absence of comprehensive legislation, INGAA does support repeal of the Fuel Use Act and incremental pricing under Title II of the NGPA. Congress should act expeditiously to adopt such legislation on a stand-alone basis.

S. 2285 (ADMINISTRATION BILL)

I would like to turn now to the bill recently proposed by the Administration, S. 2285. In our view, the Administration bill is badly flawed, hopelessly one-sided, and a threat to the stability of the natural gas industry. The bill would decontrol all gas as of April 1, 1987, an event that would release tremendous upward pressure on average natural gas prices at a time when the industry is already struggling to reduce costs in order to hold on to market share in the face of plummeting oil prices. Yet, incredibly, the bill contains absolutely no provision even to assist in the renegotiation of high price, high take contracts.

The Administration boldly assumes that such renegotiations will occur. This leap of faith is not justified by experience. As this Committee knows, our industry has been attempting to renegotiate these contracts for years with only limited success. Yet the Administration bill would grant producers of lower cost gas the right to higher prices in less than a year's time. The Administration's premise that with its bill enacted all obstacles to renegotiation will simply melt away defies reality.

Exacerbating this problem further is the area rate provision of the bill (Sec. 203). This provision would prop up the prices paid under certain contracts when the removal of controls would otherwise result in a price drop. Apparently the Administration believes that government intervention into the contract process is acceptable when it results in higher prices for producers and higher costs to consumers but opposes such intervention when it could result in lower, market-responsive prices. The Administration, for obvious political reasons, characterizes its proposal as lowering gas prices to consumers, but this is clearly a wolf in sheep's clothing. By statutorily propping up the price and overriding the 104 and 106(a) contract terms, the Administration has eliminated any incentive for producers to renegotiate these contracts with the pipeline/purchaser in the context of a so-called "free" market.

As for the carriage provisions of the bill, I do wish to point out that the bill contains the unworkable legal standard of mandating transportation "without discrimination" when the appropriate legal standard under the Natural Gas Act and other similar statutes has always been "without undue discrimination," or words to that effect.[7] The strict "without discrimination" language could render illegal such common practices as volume discounts, mileage sensitive rates, zones of reasonable rates, the first-come, first-served standard of Order 436, and other efforts to tailor carriage service to the needs of individual customers. It is exactly for reasons such as these that Congress has consistently recognized that the appropriate legal standard should be "undue discrimination." Similar language must be included in the bill to give FERC the flexibility it would need to implement this carriage provision, should it be enacted.

INGAA is, however, in agreement with the provisions of S. 2285 repealing portions of the Fuel Use Act and incremental pricing (Title II of the NGPA). It is long past time to let the marketplace, and not an outdated statute, determine the type of fuel to be used in any given application.

S. 1302

INGAA supports completely the thrust of S. 1302, providing it is coupled with a mechanism to encourage the renegotiation of high price, high take-or-pay contracts. We believe the contract expiration approach to old gas decontrol is basically fair. The provision allowing the renegotiation of such old gas contracts is also a concept that INGAA can support.

The gradual nature of phased deregulation is what makes this proposition workable. I would like to note, however, that Section 121(f)(5) of S. 1302 appears to force immediate deregulation of life-of-lease contracts, whereas long-term contracts would remain in effect at regulated prices for their full term unless the parties mutually agree otherwise. As written, Section 121(f)(5) would undercut the gradual deregulation otherwise intended by the bill, and we recommend that this provision be deleted.

S. 1251, S. 2205

INGAA is in full support of S. 1251 and S. 2205, which are directed toward removing restraints on the use of natural gas.

As mentioned earlier, INGAA supports immediate repeal of incremental pricing and the gas restrictions in the Fuel Use Act. We believe such action would not only foster the increased use of natural gas but would also be in harmony with the concept of select use of natural gas for clean air compliance. INGAA believes that the marketplace should determine the technology to be used when complying with environmental emissions standards for controlling acid rain. Should Congress mandate that specific technologies, such as scrubbers, be required as the means of reducing emissions from coal-fired plants, the Congress would not only be placing shortsighted limits on potential natural gas markets but would also be reducing the economic viability of coal-fired plants. Thus, a policy of "free economic choice" for compliance with air quality standards could result in increased use of both natural gas and coal.

Incremental pricing is another anachronism that no longer serves any useful purpose. In fact, it acts as a potential roadblock to full utilization of natural gas for industrial fuel. Congress recognized the misguided effect of incremental pricing when in 1980 the House voted against implementation of the second phase of incremental pricing. The time has come to repeal incremental pricing altogether.

If comprehensive, balanced natural gas legislation is not possible this year, INGAA strongly supports moving forward with Fuel Use Act/incremental pricing legislation on a stand-alone basis. In our opinion, it is time to move forward on those areas of legislation upon which all segments of the industry agree and stop holding those positive proposals hostage to agreement on other, more controversial issues.

OPEN ACCESS

As INGAA has testified previously, we would support a legislative package granting open access to pipelines if such legislation also addressed the problem pipeline/producer contracts. In our view, an open access requirement should provide the "undue discrimination" standard discussed previously. Also, we continue to believe that transportation rates should be set on a pipeline-by-pipeline basis. Finally, adjustment of service obligations should also be permitted where an local distribution customer of a pipeline uses interruptible carriage extensively but then swings back to the pipeline supplier for firm service when circumstances warrant. A pipeline cannot be expected to maintain reserves to meet its full service obligation to a customer if the customer uses the pipeline only as a supplier of last resort. Order 436 failed to address this situation.

Whether carriage is provided under Order 436 or some legislative alternative, pipelines and customers must be free to agree on the basic long-term service to be provided by the pipeline. Because these negotiations not only involve the customers and the pipelines but also state regulators, consumers, end users and producers, the Commission must have the discretion to take into account the unique circumstances of each case as required to best serve the public interest. Mandating carriage will not eliminate the need for customers and pipelines, whether transporters or suppliers, to agree on the service to be rendered.

RM86-3

In FERC Docket No. RM86-3 the Department of Energy (DOE) proposes to raise ceiling prices for old gas, which would compound the nonmarket-sensitive contracts problem.

While the NGPA clearly provides the Commission with authority to increase the ceiling price for old gas, the price must be just and reasonable within the meaning of the Natural Gas Act. In short, just and reasonable prices must be cost-based, although they can also include non-cost factors. The DOE proposal is not cost-based, is not just and reasonable, and is therefore unlawful. It is ironic that the DOE believes its proposal reflects "current market realities" when spot prices are below $1.00 per MMBtu, WACOGs are

$2.31, and market-responsive new gas is currently being sold on average for $2.19, and dropping. And all of this is in the face of plummeting oil prices. It is also inconsistent for the DOE on the one hand to advocate market-based pricing for old gas while on the other proposing nonmarket-related incentive prices to facilitate supply response.

Over 90 percent of contracts for old gas contain provisions that entitle the producer to the highest legally authorized price for its gas, commonly referred to as area rate clauses. We are concerned that the DOE proposal could trigger these provisions upon the finalization of a rule, a fact that the DOE persistently ignores. If this were the case, 90 percent of the old gas would automatically go to $2.56 per MMBtu unless the Commission prohibits operation of these contract provisions. The so-called "good faith negotiation rule" would allow the producer to walk away from its contract if the pipeline does not agree to pay the full ceiling price. Inevitably, WACOGs would rise and take-or-pay exposure would increase. It could also result in unwarranted higher prices to the ultimate consumer. The DOE disputes this and says that the higher priced old gas will displace high price gas. In doing so, it overlooks the reality of area rate clauses, the depressed market, and the general lack of incentives for producers to renegotiate under the DOE proposal. Thus, the DOE's faith in cheaper old gas displacing gas subject to high price, high take contracts is misplaced.

INGAA has recommended that the Commission dismiss the DOE proposal. It is not supported by an adequate record as explained in our written comment, it is economically unsound, and it would inhibit market forces from working to the benefit of the ultimate consumer. If, however, the Commission determines to increase the price for flowing gas on a just and reasonable basis, it must also provide the means of renegotiation of problem contracts and specifically preclude pricing provisions in existing old gas contracts from automatically entitling the producer to the ceiling price. If prices for flowing gas must rise, incentives for renegotiating high price, high take contracts must be provided in order to mitigate existing market distortions and not create new ones.

CONCLUSION

I commend the Committee for its willingness to consider legislative issues beyond FUA. To summarize INGAA's position, we believe that Congressionally sanctioned deregulation of expired and expiring contracts, as well as renegotiated contracts, is the best way to deal with old gas pricing. However, such legislation must be coupled with provisions addressing the critical take-or-pay and high-price contract problems facing the industry if consumers are truly to be protected against unwarranted higher gas costs.

If such comprehensive legislation is not possible in this session of the Congress, we strongly urge legislation repealing the gas use limitations of the FUA and Title II of the NGPA be moved forward on a separate, expedited legislative track.

That concludes my statement, Mr. Chairman. I would be pleased to answer the Committee's questions.

FOOTNOTES

1. These data are summarized in Table 1, which is attached.

2. Recent PGAs filed at FERC as reported in Foster Associates, *Current Purchased Gas Costs of Interstate Pipelines*, dated April 24, 1986.

3. Estimates based on the source referenced in footnote 2 and INGAA survey data.

4. *Id.*

5. *Id.*

6. *Id.*

7. See, for example, *Federal Power Act* (16 U.S.C. Sec. 824d(b)): "no utility shall...make or grant undue preference...or subject any person to undue prejudice or disadvantage...." and (16 U.S.C. Sec. 824e(a)): rates are not to be "unjust, unreasonable, unduly discriminatory or preferential...."; *Interstate Commerce Act* (49 U.S.C. Sec. 13(4)): "...any undue, unreasonable, or unjust discrimination...."; *Communications Act of 1934* (47 U.S.C. Sec. 202(a)): "It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination...."

TABLE 1

TAKE-OR-PAY EXPOSURE AS OF 12/31/85
(According to 10-Ks)

Name	Exposure ($Million)	Page in 10-K
Coastal Corporation1/	177	342/
HNG/Internorth3/	125	482/
Natural Gas Pipeline	150	114/
Northwest	75	28
Northwest Central	35	26, 27
Panhandle Eastern	800	F-22, 23
Southern	700	37, 382/
Tenneco	2,000	39-41
Texas Gas (CSX)	105	38, 392/
Transco	675	43-45
Trunkline	700	F-12, 13
United Energy5/	572	392/
TOTAL	6,114	

1/ Includes ANR Pipeline and Colorado Interstate.

2/ Refers to annual report.

3/ Includes Florida Gas Transmission, Northern Natural, and Transwestern.

4/ Refers to pipeline's 10-Q. For year ending 9/30/85.

5/ Includes United Gas Transmission and Sea Robin. For Year ending 9/30/85.

Source: INGAA Survey of Member Companies.

TABLE 2

COMPARISON OF TAKE-OR-PAY EXPOSURE WITH INDUSTRY REVENUES AND EARNINGS

($ billion)

	1985		$9.4 Billion Estimated Take-or-Pay Exposure[1] As A Percentage of 1985	
	Revenues	Earnings	Revenues	Earnings
Integrated Petroleum				
Top 10	363.0	14.1		
Next 12	71.3	4.8		
TOTAL	434.3	18.9	2%	50%
Gas Pipelines				
Major	37.4	2.6		
Other	2.0	0.1		
TOTAL	39.4	2.7	24%	348%
Independent Oil & Gas	10.1	0.1	93%	9,400%
Gas Distributors	36.0	1.8	26%	522%

1/ Cumulative exposure as of year-end 1985.

Source: Line of business earnings and revenues. Energy Performance Review, "1985 fourth quarter and annual summary," Appendix A, pp. A1-A18, April 1986.

TABLE 3

AVERAGE NEW AND HIGH COST GAS PRICES BY INDICATED PRODUCERS

Producer	Overall Average Prices (including Old Gas) ($/MMBtu)	Average New and High High Cost Gas Price Received* ($/MMBtu)
Amoco	2.32	4.28
Union Oil	2.38	4.17
Conoco	2.58	3.86
Texas Gas Exploration	2.83	3.76
Shell	2.64	3.73
Exxon	2.69	3.69
Mobil	2.43	3.64
Diamond Shamrock	2.69	3.49
Chevron	1.83	3.48
Texaco/Getty	2.37	3.47
Champlin Petroleum	2.46	3.39
Marathon	2.52	3.38
Sun	2.49	3.37
Arco	2.47	3.27
Tenneco Oil	2.42	3.24
Cities Service	1.87	3.17
Phillips	2.00	3.14
Average	2.39	3.60

* Sections 102, 103, 105, 106(b), 107 & 108

NOTE: Actual annualized prices from pipeline PGAs filed second half of 1985 as contained in EIA PGA data base (March, 1986, unpublished).

Senator NICKLES. Mr. O'Neill, thank you very much.

Our next panelist is Keith Bailey, president of Northwest Central Pipeline from Tulsa, OK.

STATEMENT OF KEITH E. BAILEY, PRESIDENT, NORTHWEST CENTRAL PIPELINE CORP.

Mr. BAILEY. Thank you, Mr. Chairman.

In addition to the role of president of Northwest Central, I also am responsible as chairman of the board of Williams Pipe Line Co., a major independent common carrier oil pipeline. And both of these companies are subsidiaries of the Tulsa-based Williams Companies.

Mr. O'Neill discussed the very real take or pay issues raised by the high priced non-market responsive contracts in today's marketplace. I want to focus for a moment on another aspect of those same contracts, and that is their impact on the incentive for producers to drill new wells.

Senator NICKLES. Mr. Bailey, could you pull that microphone up a little closer, to really get right into it.

Mr. BAILEY. If, as DOE seems to contend in its support for its version of gas deregulation, the primary purpose of any bill is to provide economic stimulus to develop as yet undeveloped reserves, then the first market distortion one should attempt to address are those contracts that exist above current market price levels.

Just as the price controls on old gas during periods of supply shortage resulted in prices for incremental supplies which were above the true market price levels, in today's surplus environment the above-market contracts cause prices for incremental supplies to be lower than they would otherwise be.

With the existing surplus of gas, it is not surprising that there is little current economic incentive to producers to seek and develop new supplies. That is exactly the result one would expect.

If the DOE's intent is to provide producers subsidies in a period of oversupply, it should say so directly rather than cloaking their proposal in free market rhetoric, because it is clear that the market does not provide both consumer relief and producer incentives in the same time frame. In this regard, Senator Nickles, your bill is clearly superior to the DOE bill, as it does provide incentives to producers and it does so while matching those incentives much better to the timing of the marketplace.

The second point I want to address is one that you raised earlier with Secretary Herrington, and that is the appropriate legal standard for the provision of transportation services. I feel my 22 years in the common carrier oil pipeline business offers a unique background from which to view this issue.

The proper legal standard is "without undue discrimination," as opposed to the DOE's proposed "without discrimination" standard. While there is an obvious emotional appeal to the latter, it is clear that Congress has long recognized the need to provide regulatory agency flexibility to deal with the real world needs of the industry it regulates.

The Federal Power Act, the Interstate Commerce Act, and the Communications Act of 1934 all contain "undue discrimination" type of standards. The very economic character of pipelines makes it important to offer a rich range of services, targeted to address specific market niches, in order to maximize system throughputs.

This type of multidimensional tariff offering would appear to be precluded by a "without discrimination" standard. Yet, it is exactly this type of tariff offering that the market demands and which will best meet the broader social and economic objectives of the various legislative proposals being considered.

I heard Secretary Herrington say that his concept of "without discrimination" would encompass many of the practices cited in defense of the "undue discrimination" standard. Given the fact that the legislative and legal history of the "undue discrimination" standard is well developed, the courts are very apt to impute a different and more restrictive intent to the proposed DOE standard than it appears Secretary Herrington would desire.

In addition, administrative agencies tend to be somewhat narrow in their interpretive approach under the best of circumstances. To handcuff the FERC with a "without discrimination" standard ensures that the very real needs of the market will not be fully met and that the resulting transportation will fall short of your expectations.

I strongly urge the Congress to incorporate an "undue discrimination" standard in any transportation legislation it considers, and suggest that Secretary Herrington's comments today would support such an approach.

I also appreciate the opportunity to appear today and would be happy to answer questions at the appropriate time.

[The prepared statement of Mr. Bailey follows:]

Hearings Before The

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

On Pending Natural Gas Legislation:

S. 2285

S. 2205

S. 1302

S. 1251

S. 834

May 20, 1986

Washington, D.C.

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Oral Comments By

Keith E. Bailey

President, Northwest Central Pipeline Corporation

and

Chairman, Williams Pipe Line Company

Tulsa, Oklahoma

Mr. Chairman and Committee Members:

My name is Keith Bailey and I am president of Northwest Central Pipeline Corporation and Chairman of the Board of Williams Pipe Line Company, both subsidiaries of the Tulsa, Oklahoma, based Williams Companies. Northwest Central and its sister company, Northwest Pipeline Corporation, are both interstate natural gas pipelines and are members of the Interstate Natural Gas Association of America (INGAA).

Williams Pipe Line is a common carrier oil pipeline. I appreciate the opportunity to express my viewpoint on these very important issues confronting this committee today.

Regulation of natural gas prices has been a part of the fabric of the natural gas industry for so long that there are relatively few active members of the industry who remember its genesis. One thing that is clear, however, is the impact that pervasive regulation has had over time.

Economists could probably craft a compelling argument that during the early days of regulation, prices were artificially inflated as for a long period of time they were sufficient to create supplies in excess of demand. This, of course, changed as we approached the decade of the seventies and the latter half of that decade was characterized by inadequate incentives to producers to seek and find new reserves to replace those being used by a consuming community that was enjoying bargain basement prices for the commodity it used. Of course, the NGPA, incremental pricing, and the Fuel Use ACt were the response to this and have, in a broad sense, had the desired impact. We are once again in a supply surplus situation as demand has fallen away dramatically and additional resources have been brought to market by the producing sector. It is against this backdrop that you are considering a variety of legislation today.

I expect the motives of various members of this committee and your colleagues in Congress differ somewhat as to why this seems to be a good time to consider modifying the regulatory framework for natural gas. Clearly, some members' primary motive is to bolster a producing sector which is reeling under the current surplus and the semi-free market forces that exist as a result of NGPA. Others see this as an opportunity to extract still further short-term benefits for consumers and many more are arrayed in the spectrum that exists between these two clearly contradictory objectives. My point in raising this is that it highlights perhaps the major economic role regulation has played in the past and that is to serve as a shock absorber which buffers the ultimate marketplace from the kinds of price volatility that characterizes commodity pricing in a free market. That has apparently been an important social value embodied in past legislation, including NGPA, and is one which would be discarded by, for example, the DOE bill under consideration here. Senator Nickles' bill is the one which perhaps best addresses these traditional values of dampening out consumer price volatility while allowing the system time to adapt to a more rational wellhead pricing structure as the remaining vestiges of regulation work their way out of the system.

It seems to me to be important that, as a first step, this committee agree on its policy objectives. It is obvious that, in the short-term, both producers and consumers cannot enjoy tangible financial benefits as one will always benefit at the expense of the other insofar as current pricing is concerned. It is also clear that producers, pipelines, local distribution companies, and residential and small commercial consumers do not necessarily share a commonality of interest insofar as the size of the aggregate market is concerned. A fifty percent increase in the price of gas means that a producer can sell one-third less gas while still maintaining current income levels and at the same time increasing the value of and extending the life of the remaining reserves. In that situation, pipelines and LDC's throughputs are immediately reduced by one-third causing earnings to decline and ultimately when the regulatory process plays itself out and full cost of service recovery is restored to the pipeline and distributor, the consumer will see his costs rise over and above the gas cost increase he has already absorbed.

It is exactly this sort of win/lose phenomena that can result in public pressure to comprehensively reregulate the industry, thus reversing the gains that have already been made in the transition to more rational gas markets.

This does not mean that the status quo is necessarily the best answer, although there is much to be said for letting NGPA play itself out. Should the consensus of this committee and Congress be that its ultimate objective is to accelerate the point in time at which free market forces are driving gas exploration and production, it can do so without immediately devastating consumers and those segments of the industry which rely on the size of the aggregate gas market for their well-being.

As I said earlier, Senator Nickles' bill provides a good framework in this regard. By allowing repricing in new, expiring, and renegotiated contracts, more gas is brought to market levels earlier than would be the case under NGPA. It should be made clear, however, that congressional intent in passing such legislation is for the resulting price after deregulation to be market driven and not determined either directly or indirectly by reference to any NGPA price category. In the same vein, the move to market sensitive pricing could be enhanced if Congress were to determine that the price for all gas from any well spudded after a date certain, for example June 1, 1986, would also be market driven.

With current average WACOG's of $2.44/MCF and spot market prices approaching $1.00/MCF in some markets, it is obvious, in the short-term, that the net effect of exposing all wellhead gas to market forces will be to increase the downward pressure on prices. This does not detract from the fact that true market pricing will result in more rational basis for decisions in both the exploration and production process and in consumer markets and that the long-term interests of both producers and consumers might best be balanced by such an approach. Dealing with only a part of the gas supply, as has been suggested in some of the bills being considered, cannot and will not produce truly rational market driven pricing.

As pointed out earlier, the critical public policy question in this debate is whether or not Congress wishes to expose the consuming public to the full workings of a free market and the inherently more volatile nature of such a market.

Under current law, until all regulated gas depletes, there will still be vestiges of both artificially high and low wellhead pricing in the system; therefore, the current FERC practice of rolled in pricing remains a logical approach and Congress could consider affirming it by statute.

Congress should also consider carefully the legal standard to which any transportation provision is held. A standard of "without discrimination" such as that proposed by DOE can create some very perverse results. Strictly applied, this could disenfranchise traditional residential and small commercial customers. It could deprive those segments of the market with fewest options during times of gas supply constraint. It could drastically alter historic supply/demand patterns and balances as between various geographic regions. This is one area my 20 plus years of experience in the common carrier oil pipeline business gives me the ability to address with particular authority, and I assure you that an "undue discrimination" standard is essential in order to allow transportation to develop in a logical and a socially acceptable way. You may ultimately elect to provide the FERC the authority to mandate open access transportation, but you should provide them the discretion to vary the provisions of any particular pipeline tariff offering in order to best meet the public interest in each particular set of circumstances.

I recently had the occasion to testify at the FERC on the issue of RM86-3, which is the pending DOE proposal to devintage old gas. That is the regulatory alternative to the DOE deregulation bill that is before this committee today. I have attached a copy of that testimony to my prefiled statement and do not propose to go over it in detail here. I would simply point out that it focuses on the one-sided nature of the DOE proposal and its logical consequences in the marketplace. Those consequences, as they apply specifically to our company, are discussed in some detail and they are illustrative of the negative impact and severe limitations of a partial resolution of non-market pricing. It should be clear from the examples discussed that anything less than a comprehensive solution is really no solution at all.

Earlier, I suggested some enhancements Congress might consider to Senator Nickles' bill to accelerate the move to a free market in natural gas. Let me close by briefly discussing two more suggestions.

First, Congress should lift all barriers to the use of natural gas. To the extent the Fuel Use Act and Incremental Pricing served a purpose, it is clear they have outlived their usefulness. Expansion of the size of the aggregate market is the most obvious win/win situation for all sectors of the industry as well as the ultimate consumer and is the area on which the strongest consensus seems to exist today.

Second, to the extent that Congress feels that inadequate incentives exist for producers, it should first address that concern through revision in the tax code and not through the creation of an environment in which the incentive is provided by artificially high prices which are solely a creature of regulation. This latter approach creates illogical economic incentives and is done at the direct expense of the consumer and those sectors of the industry that exist downstream from the wellhead. Tax code revision, on the other hand, can allow producers to enjoy greater financial benefits at existing price levels.

I do think Congress can fashion legislation that constructively addresses the legitimate concerns of all sectors of the industry and the consuming public. It can do so while meeting the public policy objectives that have traditionally affected this industry. It cannot achieve this objective if it stops short of comprehensive wellhead pricing legislation, and the status quo is superior to any legislation that deals with only a portion of the problem.

RM86-3, currently under consideration at the FERC, has the potential of dramatically altering the environment in which these various legislative proposals are being considered. Because it is flawed in its one-sidedness, encroaches on legislative prerogatives, and because the FERC is limited in its statutory authority to deal with the issue of wellhead gas pricing in a comprehensive manner, Congress should seriously consider a legislative stay until such time as it fashions a piece of comprehensive legislation.

Again, I appreciate the opportunity to testify today and will be happy to respond to questions at the appropriate time.

PUBLIC HEARINGS BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
ON RM86-3-000

APRIL 11, 1986

WASHINGTON, D.C.

****

ORAL COMMENTS BY

KEITH E. BAILEY, PRESIDENT

NORTHWEST CENTRAL PIPELINE CORPORATION

TULSA, OKLAHOMA

My name is Keith Bailey and I am president and chief operating officer for Northwest Central Pipeline Corporation, a wholly owned subsidiary of The Williams Companies, headquartered in Tulsa, Oklahoma.

I appreciate the opportunity to present my views and those of The Williams Companies on the issue of RM86-3-000. In doing so, I do not intend to discuss the legal aspects of the proposed rule or the Commission's authority to enact it as I know you will receive ample advice on that subject from others.

My remarks today will be brief, as the point I want to emphasize is a simple point, yet one that is critical in judging the merits of the Department of Energy's proposal to eliminate vintaging of old gas prices. As the recent EIA report "An Analysis of Natural Gas Contracts - Volume 1: Old Interstate Gas" so vividly points out, the

SUBSTANTIAL MAJORITY OF OLD GAS CONTRACTS DO NOT HAVE MARKET OUT PROVISIONS. IN FACT, EIA ESTIMATES SOME 89.5 PERCENT OF OLD GAS CONTRACTS FALL IN THIS CATEGORY.

THE REPORT MAKES IT CLEAR THAT WITHIN A SIGNIFICANT PERCENTAGE OF THESE NON-MARKET RESPONSIVE CONTRACTS, SPECIFIC INDEFINITE PRICE ESCALATION CONTRACT TERMS SUCH AS MOST FAVORED NATION, MAXIMUM LAWFUL PRICE, AREA RATE AND SOME OIL PARITY PROVISIONS WILL SERVE TO IMMEDIATELY PUSH GAS PRICES TO THE NEW PRICE CEILING LEVEL. THIS WILL HAPPEN IRRESPECTIVE OF THE "SO-CALLED" RENEGOTIATION PROVISION SET OUT IN THE DOE PROPOSAL. THAT RENEGOTIATION PROVISION ITSELF WILL PLACE UPWARD PRESSURE ON PRICES, AS MANY PIPELINES WILL BE FACED WITH THE HOBSON'S CHOICE OF PAYING AT OR NEAR THE NEW MAXIMUM LAWFUL PRICE IN ORDER TO AVOID LOSS OF THE UNDERLYING RESERVE. THE APPARENT SINGLE BITE AT THE APPLE THAT DOE PROVIDES HISTORIC

PURCHASERS WILL ALMOST ALWAYS CAUSE THAT PURCHASER TO ERR ON THE HIGH SIDE EVEN IF THEY FEEL THEY CAN RISK BIDDING BELOW THE MAXIMUM LAWFUL PRICE.

I AM HERE TODAY TO TELL YOU THAT THE CURRENT GAS MARKET CANNOT TOLERATE ANY INCREASE IN PRICE. FOR EXAMPLE, NORTHWEST CENTRAL HAS A CURRENT NET EFFECTIVE WACOG OF $1.95/MCF WHICH, FOR THE SIX MONTHS BEGINNING APRIL 23, WILL DROP TO $1.54/MCF. JURISDICTIONAL SALES MARGINS AT BOTH OUR LEVEL AND OUR DISTRIBUTOR CUSTOMER LEVEL ARE BELOW NATIONAL AVERAGES. DESPITE WHAT MAY VERY WELL BE THE MOST COMPETITIVE RATES IN THE NATION, NORTHWEST CENTRAL PIPELINE IS SEEING ITS MARKET ERODED BY OIL. TO PLACE IMMEDIATE UPWARD PRESSURE ON PRICE, AS THE DOE PROPOSAL WOULD DO, RAISES THE VERY REAL RISK OF PERMANENT STRUCTURAL DAMAGE TO THE OVERALL SIZE OF OUR GAS MARKET. IN THE EXTREME, THIS PROPOSAL HAS THE POTENTIAL FOR RAISING OUR

COST OF GAS BY $1.18/MCF. THIS IS CLEARLY NOT IN THE BEST INTEREST OF EITHER OUR PRODUCERS, OUR COMPANY, OUR DISTRIBUTORS, OR OUR LONG TERM CONSUMER. TO ADOPT THIS PROPOSAL ON THE HOPE THAT, OVER TIME, BASIC ECONOMIC FORCES WILL ULTIMATELY SERVE TO PLACE DOWNWARD PRESSURE ON PRICES IN THE CURRENT PERIOD OF OVER-SUPPLY IS TO IGNORE THE REALITY OF THE PROBLEMS CREATED BY NON-MARKET RESPONSIVE CONTRACTS.

THE COMMISSION WELL RECOGNIZES THE PROBLEM RAISED BY NON-MARKET RESPONSIVE HIGH PRICE CONTRACTS AND, WITHOUT DEBATING THAT ISSUE, I WOULD SIMPLY POINT OUT THAT, TO DATE, THE COMMISSION HAS APPARENTLY BEEN DISSUADED FROM DEALING WITH THAT PROBLEM. IF THE COMMISSION WERE TO ADOPT THE DOE PROPOSAL, IT WOULD ADD A WHOLE NEW LAYER OF NON-MARKET RESPONSIVE PROBLEM CONTRACTS. IT WOULD

NOT QUICKLY, IF EVER, ACHIEVE ITS APPARENT OBJECTIVE OF INCREASING COMPETITION IN THE GAS INDUSTRY AND WOULD CAUSE IMMEDIATE SUBSTANTIAL INCREASES IN CONSUMER PRICES AT A TIME WHEN THE INDUSTRY CAN LEAST AFFORD IT AND WHEN UNRESTRICTED MARKET FORCES WOULD HAVE AN EXACTLY OPPOSITE EFFECT.

I SAID I WOULD BE BRIEF, SO LET ME CLOSE BY MAKING SEVERAL OBSERVATIONS.

- IF THE COMMISSION'S PRINCIPAL CONCERN IS TO AVOID PREMATURE ABANDONMENT OF EXISTING GAS RESERVES, IT CAN DEAL WITH THAT ISSUE DIRECTLY ON A CASE BY CASE BASIS. MY LAWYERS TELL ME THE COMMISSION CURRENTLY HAS THIS TYPE OF AUTHORITY WITHIN ITS SPECIAL RELIEF POWERS AND IT CLEARLY IS IN BOTH THE PIPELINES' AND PRODUCERS' INTEREST TO PRESERVE RESERVES AND PRODUCTION CAPABILITY THAT CAN BE BROUGHT TO MARKET AT PRICES

THAT MEET THE ECONOMIC REQUIREMENTS OF THE ULTIMATE CONSUMER. I HAVE NO DOUBT THAT THIS WILL HAPPEN WHEN AND AS IT IS NEEDED IF THE COMMISSION PROVIDES A RECEPTIVE ENVIRONMENT TO FACILITATE SUCH PRICE CHANGES.

- SO LONG AS THE COMMISSION IS UNPREPARED TO DEAL WITH THE ISSUE OF THE PROBLEM HIGH PRICE CONTRACTS, COMMON FAIRNESS, EQUITY AND MARKET REALITY DICTATES THAT IT SHOULD NOT CREATE A WHOLE NEW LAYER OF PROBLEM LOW PRICE CONTRACTS. IN TODAY'S ENVIRONMENT, NON-MARKET RESPONSIVE OLD GAS AT $2.54/MCF IS DIFFERENT THAN NON-MARKET RESPONSIVE NEW GAS AT $4 OR $5/MCF ONLY IN DEGREE AND THAT IS COLD COMFORT TO AN INDUSTRY WHICH IS STRUGGLING TO RETAIN ITS REMAINING MARGINAL MARKETS. LOSS OF THOSE MARKETS CAN ONLY RAISE THE ULTIMATE COST TO THE REMAINING HIGH PRIORITY END USERS.

- FINALLY, I AM REMINDED OF THE ACADEMICIAN WHO, WHEN CONFRONTED WITH A SET OF MARKET FACTS, OBSERVED THAT THAT WAS ALL WELL AND GOOD; BUT WOULD IT WORK IN THEORY. WE DON'T NEED THEORIES IN TODAY'S MARKETPLACE. WE NEED PRAGMATIC SOLUTIONS THAT RECOGNIZE THE REALITY OF EXISTING CONTRACT TERMS, OF PLUNGING OIL PRICES, OF AN UNWILLINGNESS TO DEAL WITH NON-MARKET RESPONSIVE CONTRACTS ON A COMPREHENSIVE BASIS AND OF A LEGACY OF 30 YEARS OF REGULATION. IN THAT ENVIRONMENT, THERE IS MUCH TO BE SAID FOR THE STATUS QUO.

- FINALLY, IF THE COMMISSION FEELS COMPELLED TO DO SOMETHING, IT SHOULD ATTEMPT TO DEVELOP LEGALLY DEFENSIBLE ALTERNATIVES TO THE DOE PROPOSAL WHEREBY INDIVIDUAL CONTRACTS CAN BE RENEGOTIATED TO MARKET RESPONSIVE LEVELS WITHOUT AFFECTING THE PRICE OF GAS UNDER ANY OTHER CONTRACTS. THE CURRENT RELATIVE

NEGOTIATING POSITIONS OF BOTH BUYERS AND SELLERS SHOULD BE PRESERVED TO THE MAXIMUM EXTENT POSSIBLE.

I APPRECIATE YOUR ATTENTION AND WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE AT THE APPROPRIATE TIME.

Senator NICKLES. Mr. Bailey, thank you very much.

Our next panelist has been with us many times, Dr. Mark Cooper, director of energy, Consumer Federation of America. Dr. Cooper.

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF ENERGY, CONSUMER FEDERATION OF AMERICA

Dr. COOPER. Thank you, Mr. Chairman.

I actually begin with the history of where the Consumer Federation has been in the last year. Back in early last summer, we testified in support of block billing because it contained, we thought, a fair solution to the old gas problem.

Later in the year, we testified in support of many of the changes that the Federal Energy Regulatory Commission had made in the transportation aspect of rule 436. We felt we were evolving toward an effective marketplace solution to the natural gas industry, and we thought that the law and the courts were strongly on our side.

The NGPA clearly earmarked the economic rents associated with old gas for historic consumers. In rule 436, the FERC finally accepted that congressional intention and allocated those rents to us.

At the same time, it created an ingenious scheme to minimize any damage that allocating the rents to consumers might have on the demand side, by simply taking old gas off the margin of decisionmaking for consumers. On the supply side, we argued that block billing would finally convince producers to utilize the provisions of the NGPA which encourage them to legally shift old gas into higher priced categories, enhancement and in-fill drilling.

We were willing to accept the more rapid dissipation of the rents of old gas in exchange for a clear set of rules that allocated those rents to those who Congress intended. Needless to say, we are not there today.

In addition to the Department of Energy's proposal to deregulate old gas administratively, we have also witnessed a lot of dilly-dallying on transportation. The legislative proposal for old gas before you today is simply and primarily an effort to undo the political compromise embodied in the NGPA.

You all remember that 18-month conference that gave birth to that compromise. Producers got partial and phased decontrol of newly discovered gas. Consumers got the economic rents of old gas. The producer side of the bargain was fully executed. Indeed, some would say that the very generous interpretations put on the law by the Federal Energy Regulatory Commission gave producers more than they were supposed to get.

Consumers, on the other hand, have to wait to get their part of the bargain. They have to consume old gas at the forever controlled prices.

Having gotten what they bargained for and more, the owners of old gas now want a second bite of the apple. They now want to go back and take back the remaining rents from old gas. We see no reason to renegotiate. We suffered through the price fly-up of 1980 through 1983. Today the price of oil is almost exactly what Congress said it would be at this state in 1978, a rather remarkable turn of events. We lived up to our part of the bargain and we expect the other side to do the same.

Having mentioned the price of oil, let me also respond to the observation made by the Department of Energy in support of its legislation that in the year after partial decontrol natural gas prices declined by five percent. That is true. Oil prices also declined by 7 percent.

Now, the Department of Energy seems to confuse correlation with causation. Gas prices did not decline last year because gas was decontrolled. They declined because oil prices did. More decontrol will not get you lower gas prices. Lower oil prices will get you lower gas prices.

There may be some efficiency gains to be had by stimulating production of old gas, but we just do not believe the numbers that are on the table. And we think that if producers put up an active effort under the NGPA to rework old gas fields, we would get a large part of what the Department of Energy says we would.

With respect to transportation, if we need a bill to tell FERC to do what the courts have told it to do, fine. But we also believe the language in the administration's bill would do more harm than good, because it raises the specter of demand-based or Ramsey pricing.

Now, demand-based pricing is an inevitable part of any partially competitive industry. But it should also be part of a carefully balanced regulatory system in which those who have the least market power are protected, and this was the central concern we voiced before this committee about rule 436. As drafted, we think the administration's bill would make matters worse.

With respect to contracts, finally, we believe that the contract between the Government and consumers embodied in the equity agreement under the NGPA is just as binding as the high cost contract signed under the regulatory regime of the NGPA.

If you are going to raise the price of old gas by law, you ought to lower the price of new gas by law and abrogate the other insidious provisions agreed to under the very regulatory regime which you are abolishing.

Thank you.

[The prepared statement of Dr. Cooper follows:]

Consumer Federation of America

TESTIMONY OF
DR. MARK N. COOPER
DIRECTOR OF ENERGY,
CONSUMER FEDERATION OF AMERICA
before the
SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
of the
ENERGY AND NATURAL RESOURCES COMMITTEE,

on

NATURAL GAS LEGISLATION

MAY 20, 1986

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

Mr. Chairman and Members of the Committee.

My name is Dr. Mark N. Cooper. I am Energy Director of the Consumer Federation of America (CFA). CFA is composed of 200 consumer, senior citizen, low income, union, farm, public power, and cooperative organizations representing more than 35 million people.

I appreciate the opportunity to appear before you today to present our views on the legislation proposing the decontrol of old gas which is before the committee.

In the past four years, I have testified about a dozen times on Natural Gas well-head pricing and transportation policy before this and other committees of the Congress and several Federal agencies. In the past year I have testified twice before this committee.

The Committee is to be commended for its concern over this important issue, but little has changed and I believe that it is time to move on to other matters. The simple fact is that the legislation we are considering today is a non-starter, unworthy of the valuable time and considerable talents of this Committee.

The legislation before you is not needed and will not contribute anything positive to national energy policy.

THE SHORT, TROUBLED LIFE OF FERC ORDER 436

The Consumer Federation of America testified early last summer in support of the block billing proposal contained in Proposed Rule 436 because it contained a fair solution to the "old gas problem." Later in the year we testified in support of many of the changes that the

Federal Energy Regulatory Commission made in the transportation aspect of Rule 436.

We had, in fact, evolved toward an effective marketplace solution in the natural gas industry. Our position was strongly supported by both the law and the courts.

The NGPA clearly earmarked the economic rents associated with old gas for consumers. In Rule 436 the FERC finally accepted the Congressional intention and allocated those rents to historic, firm sales customers. At the same time, it created an ingenious scheme to minimize the deleterious effects that allocating those rents to consumers might have on the demand-side of the market by taking old gas off the margin of decisionmaking.

On the supply-side, block billing would have finally driven producers to utilize the provisions of the NGPA which encouraged them to legally shift old gas into higher priced categories. We were willing to accept the more rapid dissipation of the rents of old gas in exchange for a clear set of rules that allocated the economic rents to those who congress intended.

On the transportation side we had a strong ruling from the courts that existing transportation programs were discriminatory. Rule 436 was an attempt to codify a less discriminatory transportation program.

With the law and the courts on our side and the responsible federal agency finally committed to actually obeying the law and the courts, you might have thought that we were in the catbird seat.

You would have been wrong. As so frequently happens in the energy industry, producers and the government conspired to rob consumers of their well-deserved victory. The Department of Energy invoked never used powers to propose old gas decontrol -- a proposal which we believe violates the NGPA and one that is certain to be tested in the courts should it be adopted by the FERC. The pipelines refused to play in the transportation game, and there was enough wiggle room between the language of the program and the interpretation of the courts to let the charade of non-discriminatory carriage go on and on.

OLD GAS DECONTROL AND THE NGPA

Now comes the DOE with a legislative proposal for old gas decontrol. It is simply and primarily an effort to undo the political compromise embodied in the NGPA. I am certain that you all remember the 18 month conference that gave birth to the NGPA. Producers got partial and phased decontrol of newly discovered gas. Consumers got the economic rents of old gas.

The producer side of the bargain was fully executed. Indeed, some would say the very generous interpretations put on the law by FERC gave more to producers than they were supposed to get. Producers got their rewards in the first seven years, with final decontrol of new gas on January 1, 1985.

Consumers, on the other hand, have had to wait to collect on their part of the bargain. Over half the rents on old gas remain to be paid to consumers.

Having gotten what they bargained for and more, the owners of old gas want a second bite of the apple. They now want to take back the remaining rents of old gas.

We see no reason to renegotiate. We suffered through the price fly-up of 1980-1983. The price of oil, which was assumed to set the price of gas, is today almost exactly what Congress projected it would be. The decision was made in good faith and we have lived up to our part of the bargain.

Having mentioned the price of oil, let me also respond to the observation, made by the DOE in support of the legislation, that in the year after partial decontrol natural gas prices declined five percent. That is true. However, oil prices declined by 7 percent. The Department of Energy has confused correlation with causation. Gas prices did not decline because gas was decontrolled, they declined because oil prices did.

More decontrol won't get you lower gas prices, lower oil prices will.

THE OLD GAS SUPPLY RESPONSE

If we could put the fundamental inequity out of our mind and forget the fact that FERC had a perfectly good approach to solving the inefficiencies associated with the allocation of economic rents on the demand side, couldn't we bring ourselves to accept old gas decontrol as a supply-side efficiency measure?

There may be some efficiency gains to be had by stimulating the production of old gas, but we just do not believe the numbers. We also believe that most of those gains can be had under the NGPA.

There might be some specific instances and cases in which efficiency gains above the NGPA can be made, but there is no reason to raise the price of all old gas to get a small supply response.

NON-DISCRIMINATORY TRANSPORTATION

With respect to transportation, the bill actually admits that it will do nothing. It simply states that FERC should do what the courts have told it to do. Clearly, there is not much need for piece of legislation that does nothing.

We believe that this piece of legislation would actually do some harm. The language of the bill may actually push carriage away from non-discrimination because it raises the specter of Ramsey, or demand-based pricing.

As we read the bill, it tells pipelines that capacity will be allocated in a fashion that will be to the detriment of price inelastic customers. If this piece of legislation were passed on top of existing FERC proposals, we would face a situation in which demand-based pricing would dictate who has access and who does not.

Demand-based pricing is an inevitable part of partially competitive industries, but it should also be part of a carefully balanced regulatory system in which those who have the least market or bargaining power are protected. This was the area of Rule 436 about which we expressed our greatest concern. As drafted, this bill only increases our concerns.

CONTRACT RENEGOTIATION

The third area where the bill purports to have an impact --

renegotiation of high cost contracts -- leaves us equally unimpressed. We believe the contract between the government and consumers embodied in the equity agreement of the NGPA is just as binding as the high cost contracts signed under the NGPA. If you are going to raise the price of old gas by law, you ought to lower the price of new gas by law and abrogate the other insidious provisions agreed to under the regulatory regime you are abolishing.

CONCLUSION

Thus, there is no justification for old gas decontrol on equity grounds, none on demand-side efficiency grounds, and only little on supply-side efficiency grounds. The bill does nothing positive to create non-discriminatory transportation. It treats existing obligations between producers, pipelines and consumers in a completely unbalanced, unfair manner.

How much damage would the bill do? Probably not too much. The declining price of oil has ensured that energy prices will remain reasonable for the near future. Instead of spending time on old gas decontrol, I urge you to consider ways to ensure that the price of oil stays down, near its economic costs. That is the area in which the economy and consumers could benefit most from an active federal energy policy.

Senator NICKLES. Thank you very much.

Our next panelist is Bud Lawrence, president of American Gas Association.

STATEMENT OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION

Mr. LAWRENCE. Mr. Chairman, there are three things this committee is looking at: old gas decontrol, statutory mandatory carriage, and repeal of the demand restraints.

On old gas, AGA endorses your approach that would decontrol old gas as contracts expire or as they are renegotiated.

With respect to NGPA-regulated new gas ceilings, we like what DOE said. Deregulate them, remove these ceilings, except that they have failed to defuse indefinite escalator clauses that tie deregulated gas prices to these previous NGPA price ceilings, thereby frustrating the goal of permitting this NGPA-regulated new gas to to come to market levels.

Our concern is twofold. Number one, contract terms that tie the price back to these NGPA-regulated new gas ceilings that we should get rid of; and second, favored nations clauses that would cause prices tied to these clauses to be the rule and not the exception.

AGA's legislation position would permit wellhead prices to reach market levels, reduce interstate pipeline way cogs. It will not reduce the spot market price or the market price, but it will reduce pipeline system sales and allow them to become more competitive with spot sales and negotiated carriage arrangements, thus reducing large take-or-pay obligations that you have heard mentioned here today.

Producers now tied to these pipeline system sales would move more gas. It would increase demand and producer revenues and also result in about a 6- to 8-percent reduction in residential gas prices.

You have heard and will hear that defusing these escalator clauses is not necessary because the market will force renegotiation, and that lack of a price increase on January 1, 1985, will be given as proof positive of this. Indeed, market forces will work, especially if the contracts will permit them to work.

But I would emphasize that prices of the 102(c) gas, those contracts deregulated by the NGPA totally on 1–85, those prices are a dollar less per million Btu today for contracts signed after 1982 than those same 102(c) contracts entered into before 1982.

The main reason is that almost all post-1982 contracts have market-out clauses, whereas only about one-fourth of the pre-1982 contracts had market-out clauses. That is the engine that is driving renegotiation. These market-out clauses are not prevalent, for example, in 102(d) gas, where NGPA new gas ceilings were in effect.

Mandatory carriage legislation. In our opinion, it would slow FERC's efforts to achieve effective voluntary negotiated carriage in order No. 436. We have heard it is not working. It has only been in effect since mid-February, and even then, with the extensions and a lot of exceptions to it, the Commission has allowed out until July 21. And yet we have had 22 pipelines step up, 22 more stop up.

As we begin to resolve some of these take-or-pay problems, that is the main thing that is roadblocking some of that. You would have a lot more of it.

But also, a point that has not been mentioned in these hearings, Senator. Voluntarily negotiated carriage arrangements by local distribution companies are increasing dramatically, and State regulators are encouraging this. You have had, for example, the California Commission that just a year ago said: Carriage arrangements, never. Today they have got one of the most far-reaching proposals to encourage contract carriage arrangements.

Mandatory carriage legislation would preempt both the new State and FERC transportation progress just as there are clear signs that they are beginning—I repeat, beginning—to work. They are not totally working, but the progress is moving. Now is not the time to disrupt these flexible processes by interjecting some complex, rigid, and confusing Federal statutory formula.

Finally, there is one thing we should do right now, and that is repeal the Fuel Use Act and incremental pricing. Demand is the problem now. Oversupply and gas-to-gas competition was causing wellhead prices to go down before the oil price collapse. That is the problem aggravating pipelines' take or pay, the lack of demand.

If we get rid of the market restraints, it would benefit the consumers of two industries, gas and electric. We see a demand increase of 1 to 3 trillion cubic feet a year, one by 1990, 3 trillion by the year 2000.

As to the other two issues, negotiated carriage is working via the regulatory process, and repeal of these demand restraints should not be delayed 1 day because of the foregoing arguments and, we hope, ultimate solution for old gas decontrol.

Thank you.

[The prepared statement of Mr. Lawrence follows:]

TESTIMONY OF GEORGE H. LAWRENCE
FOR THE
AMERICAN GAS ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARINGS ON GAS PRICING AND REPEAL OF THE POWERPLANT AND INDUSTRIAL FUEL USE ACT AND INCREMENTAL PRICING
May 20, 1986

I am George H. Lawrence, President of the American Gas Association (A.G.A.). On behalf of the 300 natural gas distribution and transmission companies that are members of A.G.A., I am pleased to appear before the Committee this morning.

STATEMENT OF POSITION

Repealing the Powerplant and Industrial Fuel Use Act (FUA) and incremental pricing under Title II of the Natural Gas Policy Act (NGPA) has long been among the highest legislative priorities of A.G.A. This is even more true today in this era of falling oil prices.

A.G.A. has also adopted a new legislative position on natural gas pricing which will lead to market-responsive wellhead prices. A.G.A. is willing to change its long-standing support for controls on old gas and support old gas decontrol for expired and renegotiated gas contracts as proposed in S. 1302, sponsored by the Energy Regulation and Conservation Subcommittee Chairman Don Nickles (R-OK), if

Congress is willing to let free market forces bring down the price of NGPA regulated new gas. Specifically, we are calling for:

(1) the immediate removal of all remaining NGPA price ceilings on new gas, [1] which are keeping prices for this gas at roughly twice market levels; and,

(2) the elimination of indefinite escalator clauses, [2] in contracts for the sale of that gas, which were signed when the parties thought that this gas would never be decontrolled under the NGPA. The proposal to eliminate indefinite escalator clauses would not apply to: (a) already deregulated gas; (b) old intrastate gas; or (c) future contracts.

Although our proposal would not affect gas spot market prices, it would mean that the interstate pipelines' weighted average cost of domestic gas (WACOG) this year could decline by as much as 34 cents/MMBtu.

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[1] This encompasses NGPA §§102(d), 103(b)(2), 105(b)(3), 107(c)(5), 108, and 109.

[2] Our definition of an indefinite escalator clause is along the lines of NGPA §105(b)(3)(B)(i). It is:

> DEFINITION OF INDEFINITE PRICE ESCALATOR CLAUSE -- For purposes of this paragraph, the term "indefinite price escalator clause" includes any provision of any contract --
>
> (i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to prices for natural gas, including any price determined by reference, direct or indirect, to an NGPA ceiling price, for crude oil, or for refined petroleum products; . . . .

Note that our definition excludes any reference to subsection (ii) of §105(b)(3)(B), and does not affect price renegotiation clauses.

decreased pipeline WACOGs would mean lower consumer prices, reductions in our industry's $6.2 billion potential take-or-pay obligation, and soon thereafter, increased demand and producer revenues.

A.G.A. did not arrive at this new position lightly. Lengthy deliberations and analytical studies preceded our decision. We are, even now, vigorously opposing the Department of Energy's (DOE's) proposal to decontrol old gas by administrative fiat currently before the Federal Energy Regulatory Commission (FERC). Only Congress has the power to decontrol old gas and can use that power judiciously to ensure that, as old gas prices are allowed to rise, new gas prices are, also allowed to fall. NGPA new gas ceilings have in effect become price floors and are holding controlled new gas prices at unreasonably high levels.

The benefits of our proposal arise from subjecting NGPA regulated new gas to market forces by removing price ceilings and escalator clauses -- not from decontrolling old gas. As we have said many times before, the principal problem in today's market is not the low price of old gas, but the high price of nonmarket-responsive gas. Thus, the many consumer benefits of lower prices and reduced take-or-pay expenses come from making this NGPA regulated new gas totally market responsive. Despite our concerted efforts to make this point with DOE and FERC, they have consistently ignored the problems with high cost, nonmarket-responsive gas contracts. The Commission's inability or unwillingness, to date, to deal with high priced, nonmarket-responsive gas contracts has convinced us that Congressional action is needed on gas pricing.

The ultimate goal should be to make all gas, old and new, market-responsive. In today's volatile energy marketplace, which is dominated by rapidly declining crude oil and product prices, we need to do everything possible to stimulate gas demand by making prices more market-responsive and removing outdated constraints on its use. Our proposal will provide immediate and tangible benefits to natural gas consumers, end users, distribution companies, pipelines, and producers -- as well as to the nation's economy, its security, and its environmental policy goals.

However, this position on gas pricing should in no way detract from parallel efforts to repeal FUA and incremental pricing as soon as possible. Indeed, the new focus on wellhead pricing further confirms the need to put the repeal of demand restraints on a separate legislative track, so that action to repeal FUA and incremental pricing proceeds forthwith.

We now turn our attention to some of the specific legislative proposals before this Subcommittee. First, we will discuss Senator Nickles' bill, entitled the "Natural Gas Regulatory Reform Act of 1985." Second, we will discuss the DOE bill, S. 2285, and its many flaws. Third, we will discuss the complexities and contradictions in S. 834, a mandatory carriage proposal by Senator Bill Bradley (D-NJ) entitled the "Natural Gas Competition Act of 1985." Finally, we will discuss the great importance of repealing the Fuel Use Act and incremental pricing. Senators Pete Domenici (R-NM) and Bennett Johnston (D-LA) introduced the "Natural Gas Utilization Act of 1985" (S. 1251) on June 6, 1985, to repeal FUA and incremental pricing. Senator Nickles has also introduced a FUA repeal bill, S. 2205. It is time, and past time, to move forward on stand alone repeal of these clearly counter-productive market restraints.

I.

S. 1302 -- Phased-in Decontrol of Gas Prices

S. 1302 takes a free market approach to old gas decontrol -- permitting decontrol either upon contract expiration or renegotiation. Thus, all old gas is eligible for decontrol if the buyer and seller can work out the terms, with about 6 percent of old gas automatically decontrolled as contracts expire each year. However, we would note that S. 1302 would add a new §(f)(5) to NGPA §121. This new subparagraph could be construed as decontrolling old gas before life of lease contracts expire and is contrary to the spirit of the bill, which achieves old gas decontrol consistent with contract terms or renegotiation by the parties. Section (f)(5) creates an anomolous situation wherein life of lease gas is deregulated immediately while long-term contract gas stays regulated until contract expiration or renegotiation. Clearly, the parties would expect life of lease contracts to give them more protection than even long term contracts. To eliminate any possible ambiguity, we strongly recommend that §(f)(5) be deleted.

The market can more than offset annual price increases from 6 percent of old gas by lowering new gas prices if the remaining categories of NGPA regulated new gas are also decontrolled and indefinite escalator clauses are deactivated. According to A.G.A.'s analysis (attached as Appendix A), our proposal will lower the national WACOG by 28 to 34 cents/MMBtu by the end of 1986, depending on the underlying assumptions. Under one set of assumptions, all decontrolled gas goes to market levels, resulting in a savings of 34 cents/MMBtu. Because some currently decontrolled gas is kept above market levels due to contract terms and would not fall to market levels, a second set of assumptions is also presented. In this scenario, newly decontrolled gas (e.g. §102d) goes to the same level as currently decontrolled gas in the same category (§102c), resulting in a savings of 28 cents/MMBtu. The second assumption is conservative, given the escalator clause protection built into our proposal; however, it reflects the presence of a specific price term that may be above market in some new gas contracts.

When all of the various categories of gas are examined, we see that as decontrolled old gas rises to an assumed market price of 57% of crude oil, decontrolled new gas prices also fall to 57% of crude oil.[3] Because of the mix of old and new gas, declining prices more than offset rising prices, creating a net benefit for the consumer, lowering gas prices, increasing demand and reducing now-proliferating take-or-pay obligations. We expect that if old gas is gradually decontrolled as contracts expire or immediately decontrolled as contracts are renegotiated, as prescribed in S. 1302, its price would rise to market levels. For example, the average price of §104/106(a) gas is now $1.39/MMBtu. Under S. 1302, the average old gas price would rise via contract expiration to $1.46/MMBtu in the first year. However, this price increase can be offset by lower new gas prices if A.G.A.'s proposal is adopted, mitigating potential consumer price increases from old gas decontrol.

The price effect of old gas which is decontrolled by renegotiation cannot be quantified. However, it is assumed that the purchaser could get a quid pro quo in the form of price reductions or take-or-pay relief on nonmarket-responsive contracts. The renegotiation option is mutually beneficial to producers and pipelines because it gives both parties greater flexibility in contract adjustments to achieve marketability to their mutual benefit.

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[3] Our analysis assumed $18/barrel crude oil and $16/barrel high sulfur residual oil.

Although S. 1302 also decontrols still-regulated new gas upon contract expiration or renegotiation, A.G.A. proposes to deregulate all new gas upon enactment so that downward market presssure can begin to act on high-cost gas contracts as soon as possible. In order for market forces to work as we propose, Congress should preempt favored nation and related indefinite escalator clauses in new gas contracts. This would prevent irrational, unintended and anticompetitive effects on gas prices. Many NGPA-regulated new gas contracts include indefinite escalator clauses which the parties expected to be restrained, in perpetuity, by NGPA ceiling prices, imposed in §§102(d) 103(b)(2), 104, 105(b)(3), 106(a), 107(c)(5), 108, and 109. These clauses were never intended to ratchet gas prices far above market levels. Instead, they were intended to permit prices to rise to these ceilings, which were expected to be below market levels.

If ceiling prices are removed, then the contract no longer embodies the parties' expectations about escalator clauses. Escalator clauses in just a few such contracts could take the price of most newly deregulated gas, once again, above market levels. Moreover, such contracts may activate escalator clauses in other contracts, creating a chain reaction of ever-increasing prices. Pipelines would once again have to refuse to take this above-market gas in order to keep gas competitively priced, starting the cycle of shut-in gas, take-or-pay obligations and higher consumer prices.

The solution is to deactivate such escalator clauses before the cycle starts, just as Congress did when it enacted the NGPA. By passing the NGPA, Congress changed the rules of the game. Thus, NGPA §313 declares that §§107, 302(a) and 303 prices cannot trigger escalator clauses. If Congress changes the rules of the game again by removing NGPA price ceilings, it certainly can take action on escalator clauses again. Most contracts for currently deregulated gas were negotiated in anticipation of the complete deregulation of new gas on 1/1/85, and the parties could protect themselves accordingly. However, parties contracting for controlled NGPA new gas felt entitled to rely on the NGPA ceilings. If the ceilings are removed by law, it is entirely consistent to remove by law those contractual provisions negotiated in reliance on the ceilings which are out of step with the current market.

Since eliminating escalator clauses might leave the parties without a price determination clause, the parties should have 60 days to renegotiate. If at the end of that time, the parties cannot agree, then the producer is free to sell the gas elsewhere and the released pipeline would be required to transport the contracted for volumes of gas to its nearest major point of interconnection. This transportation "access" will allow the producer to get gas out of the field and offer it to another buyer and/or transporter.

We think that this is a fair solution to an old and difficult problem. Unlike earlier suggestions to "cap" escalator clauses according to a preset formula, our suggestion relies entirely on market forces and negotiation. Thus, we believe that it is more in keeping with the free market spirit of decontrol. While many now-controlled old gas contracts, under §§104 and 106(a), also contain these outmoded indefinite escalator clauses, they pose no problem under the basic approach of S. 1302 because they too would expire as old gas is decontrolled via contract expiration, or they would be eliminated during renegotiation.

II.

S. 2285 -- The DOE Bill

Unlike a modified Nickles bill, DOE's bill will not create a competitive wellhead market for three reasons:

> First, the DOE bill precipitously decontrols old gas on 4/1/87.
>
> Second, the DOE bill ignores the effects of indefinite escalator clauses on new gas prices which are out of step with the current market, after NGPA ceilings are removed; and
>
> Third, the DOE bill imposes a new layer of statutory Federal controls on natural gas transportation just as the industry is on the verge of entering into self-implementing transportation.

We will discuss each of these points below.

II.A.

Precipitously Raising Old Gas Prices Will Not Lower New Gas Prices or Appreciably Increase Old Gas Supplies

It is erroneous to assume -- as DOE does -- that an immediate increase in old gas prices would be more than offset by a commensurate decrease in new gas prices. Despite intense gas-to-gas competition, increasing gas-to-oil competition, and growing take-or-pay obligations as pipeline sales are displaced by carriage, the price of about 20 percent of interstate pipeline supplies remains at roughly twice market rates because of nonmarket-responsive new gas contracts. Since the price of new gas cannot automatically fall on decontrol day, 4/1/87, unless the indefinite escalator clauses are disabled, the consequences of precipitously decontrolling old gas are:

- First, precipitously raising old gas prices will force pipelines to cut back purchases of high cost nonmarket-responsive new gas to keep pipeline sales rates competitive; and,
- Take-or-pay liabilities will increase at a faster rate because pipelines will have to refuse to take even more high cost new gas to keep their sales rates competitive with spot gas and falling oil prices.

A.G.A. estimates that potential take-or-pay obligations could exceed $7 billion in 1986, and even with recent settlements and contract renegotiations potential obligations remain at $6.2 billion (see Appendix B attached). The latest A.G.A. study, an Energy Information Agency (EIA) study, and information from the Interstate Natural Gas Association of America all corroborate this figure. Furthermore, our estimate is also consistent with an analysis by the Natural Gas Supply Association (NGSA) on the take-or-pay obligations of selected pipelines -- when NGSA's data is updated with information from more recent annual reports (see Appendix C attached). These estimates, though large, do not take into account the effect of raising old gas prices, which would force pipelines to refuse to take even more high price gas.

DOE has a study, entitled The Natural Gas Policy Act Amendments of 1986, that purports to show the price and supply benefits of enacting S. 2285.[4] The inconsistencies in DOE's analysis of the purported benefits of S. 2285 are more fully discussed in A.G.A.'s Critique of the DOE Analysis. (attached as Appendix D).

While the precise supply response, if any, of decontrolling old gas can be debated, DOE's suggestion that old gas decontrol will elicit 30-34 Tcf of old gas is absurd. While there undoubtedly will be some long term supply response from old gas decontrol, all reasonable parties agree that there will be no measurable supply response in the short-term, given the current gas price outlook.

Even DOE's analysis questions, rather than supports, the predicted short-term supply response. That analysis shows no reserve increases from old gas decontrol until the early 1990s. Furthermore, DOE states that "infill drilling will not begin before the early 1990s.[5] Lastly, DOE belies a short-term supply response when it admits that the prices needed to justify additional production enhancement will not be reached before 1992.[6] Therefore, the economic benefits predicted by DOE this decade do not exist.

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[4] U.S. Department of Energy, Office of Policy, Planning and Analyses, The Natural Gas Policy Act Amendments of 1986. DOE/PE-0074, April 1986.

DOE also assumes in its analysis that many new gas contracts will be renegotiated if its bill is made law, but there are no facts to support this assumption. DOE merely states, as an article of faith, that "in a fully decontrolled market these contracts would be renegotiated."[7] In reality, nothing in the DOE proposal would force the renegotiation of nonmarket-responsive contracts. By definition, these contracts lack market-out, economic-out or price redetermination cluases; therefore, they do not respond to market forces. The DOE analysis itself acknowledges that many contracts for both "old" gas and "high-cost" gas (which now includes some old gas, e.g., Section 104c) contain indefinite escalator clauses that would prevent the contract price from declining upon decontrol, and might actually raise the contract price even farther above market levels.

Because the DOE bill abruptly eliminates ceiling prices, indefinite escalator clauses in both old and new gas contracts could actually distort gas prices instead of leading to competitive prices. In contrast, our proposal avoids this problem for both old and new gas. Under our proposal, escalator clauses are never a problem in existing contracts for old gas because the ceiling price restrains them for the life of the contract. Our proposal also deals with escalator clauses, in contracts for NGPA-regulated new gas that is decontrolled, by preempting these indefinite escalator clauses.

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[5] Id. DOE Appendix B at 13.

[6] Id.

[7] Id. at p. 21

Under the DOE proposal gas prices will not return to competitive levels. For example, a recent study by the Energy Information Agency, entitled An Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas (February, 1986), predicts that repealing old gas ceilings may create new pricing distortions. If old gas ceiling prices are removed, contract clauses in 80 percent of all old gas contracts would take the price of that gas above market rates in some cases, and below present prices in other cases. For example: (a) as much as 30 percent of old interstate gas could revert to very low, pre-NGPA prices; (b) 7 percent of old gas is indexed to oil and could go above market levels; (c) 34 percent of old gas contracts include most favored nation clauses that could take old gas prices above market levels; and (d) 10 percent of all old interstate contracts have only fixed price escalator clauses. Removing the old gas ceiling price does not mean that old gas prices will be market-driven because of the presence of indefinite escalator clauses in existing contracts.

However, DOE does not even address this problem except when decontrol causes the price of old gas to fall. In that case, proposed Section 203 of S. 2285, props-up the old gas price. This suggests that DOE is willing to address escalator clauses and tamper with contracts to keep old gas prices up, but that DOE is not willing to take similar action to bring new gas prices down. DOE's proposal to abolish ceiling prices, without dealing with the escalator clause problem, shows a profound disregard for the consequences of runaway pricing via escalator clauses, despite the warnings of an Agency that is actually within the Department of Energy.

II.C

DOE Proposes A New Layer of Federal Controls On Natural Gas Transportation

In the midst of a proposal that ostensibly deregulates natural gas, DOE has inserted a mandatory carriage provision that gives FERC the power to order interstate pipelines to carry gas. This provision would put FERC in the business of assigning pipeline capacity customer-by-customer and of substituting the Commission's judgment for pipeline operating decisions. Aside from the fact that this proposal is a bureaucratic nightmare and totally unnecessary, it is a genuine curiosity that a proposal to, in effect, nationalize private pipeline property, arises from a Department of this free market-oriented Administration. Furthermore, since the Secretary of Energy refers to his proposal as a "transportation bill", then consideration should be given to transferring -- at least this portion of the bill -- to the Senate Commerce Committee.

The Commission has just started to implement a completely self-implementing transportation program. Despite DOE's assertions that Order No. 436 is not working, to date, 22 pipelines (half of which are major interstate pipelines) have filed petitions to transport gas under Order 436 (see Table I, attached). Furthermore, we expect more pipelines to file for transportation under the program by July 1, 1986, less than one and a half months from now. Certainly, self-implementing transportation under Order 436 would be even more quickly accepted if A.G.A.'s market-responsive legislative proposal is adopted.

In the interim, transportation is continuing to take a larger and larger share of the market. According to A.G.A. statistics, gas pipeline and utility transportation to end users totalled nearly 1.4 Tcf in 1985, a 63% increase over 1984. This represents 10% of total gas utility deliveries in 1985, and 20% of gas utility industrial and electric generation deliveries.

An examination of the ratemaking trends of local distribution companies also bears out this point. In the past year, the number of LDCs offering transportation rates has increased by 35%. These transportation rates provide an opportunity for end-use customers to secure their own supply, either in the fields or from a pipeline, which the

LDC then transports from the city-gate to the customer. A recent A.G.A. study, Gas Distribution Industry Pricing Strategies: 1986 Update, showed that 70% of the respondents (54 of 79 companies) offer transportation rates and these rates cover 70 service areas.

The fact that a greater number of pipelines have not signed up for Order 436 should not be interpreted to mean that they are hostile to transportation. Instead, this reflect their reluctance to shoulder more take-or-pay liability. We have told the Commission repeatedly, in all our filings on Order 436 and more recently our filings on DOE's administrative decontrol proposal, that the possibility of aggravating take-or-pay obligations is the single greatest impediment to "open access" transportation, and FERC has repeatedly acknowledged that this is true.[8/] However, on March 26, 1986 the Commission again refused to

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[8/] See:

Statement of Policy Concerning Take-or-Pay Provisions In Gas Purchase Contracts, 47 Fed. Reg. 57268, (December 23, 1982).

Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions: Final Rule, 49 Fed. Reg. 22778, 22787 (June 1, 1984).

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol; Notice of Proposed Rulemaking, 50 Fed. Reg. 24130, 24133 (June 7, 1985).

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol; Final Rule, 50 Fed. Reg. 42408, 02433 (October 9, 1985).

III.

S. 834 -- Mandatory Carriage Bill

S. 834, the "Natural Gas Competition Act of 1985," is very similar to other mandatory carriage bills that A.G.A. has strongly opposed in the past and the points I made in Section II.C above, on the DOE proposal, are equally appropriate here. However, since S. 834 goes into the minutiae of mandatory carriage, it is even more troublesome.

A) This legislation would allow the Federal government to obtain jurisdiction over intrastate pipelines and LDCs for the purpose of requiring mandatory carriage if the state fails to certify that they will require carriage "within a time certain" according to federally-defined standards of "non-discrimination." In fact, the ultimate result of the DOE proposal would be to preempt state transportation programs. Again, this would occur just as states are stepping up to the problem in ways that suit their own circumstances. The pace-setting California PUC, which just one year ago vowed never to permit contract carriage arrangements, has adopted an aggressive program to encourage carriage arrangements for all large industrial and commercial customers.

B) The lead time granted the Commission to issue new regulations and decide protests under S. 834 is too short for proper discussion of the issues. Furthermore, since the pipeline always has the burden of proving how capacity is allocated, any person, including a buyer not a customer of the pipeline, could force a pipeline and its customers to litigate the issue of capacity allocation repeatedly before the Commission. Even though these issues now are being hammered out at FERC, at great cost and legal expense, any denial of transportation gives a protestor the right to reopen these proceedings in the future. Lastly,. S. 834 does not require that FERC ordered carriage be in the public convenience and necessity. Therefore, even if the carriage would result in higher rates or less efficient capacity utilization overall, the transportation must proceed.

A.G.A. urges this Committee to resist all attempts to force an entirely new legislative scheme on the natural gas industry.

With the trend toward distribution company carriage and state commission encouragement, and with the increasing number of interstate pipeline companies participating in Order 436, now is not the time to disrupt these flexible processes, which are working, by injecting some complex, rigid and confusing federal cookbook formula. Instead, we urge Congress to remove the remaining new gas ceiling prices and to preempt indefinite escalator clauses in these contracts. As soon as new gas becomes market-responsive, the take-or-pay problem will begin to disappear. With lower prices, pipelines will be able to take and sell more gas. They will be able to retain and even regain load lost to oil. If FUA and incremental pricing are also repealed, demand will increase further. The best solution to the take-or-pay problem has always been to sell more gas.

IV.

Stand-Alone FUA/Incremental Pricing Repeal Bill -- S. 1251

Repeal of the Powerplant and Industrial Fuel Use Act (FUA) and the incremental pricing provisions of the NGPA is a high A.G.A. legislative priority. The FUA prohibits new electric power installations and industrial facilities from burning gas as a primary energy source. Incremental pricing imposes a complicated rate and accounting mechanism that forces gas pipelines and local distribution companies to pass through to industrial boiler users surcharges on their gas rates. The folly of incremental pricing becomes increasingly apparent at a time of intense competition from imported oil, for which prices are declining dramatically, as well as from intense gas-to-gas competition. Both statutes restrict gas demand in the industrial sector and limit the customer base upon which the gas industry can spread fixed system costs.

IV.A.

Congress Should Enact S. 1251

A.G.A. strongly endorses S. 1251, introduced by Senators Domenici and Johnston, which repeals FUA and incremental pricing. Indeed, repeal of FUA and incremental pricing could help resolve many of the gas industry's current problems such as increasing take-or-pay obligations. A.G.A. therefore urges this Committee, the Senate and the entire Congress to proceed with maximum speed in its efforts to enact S. 1251. We understand that S. 2205, introduced by Senator Nickles, was intended to repeal incremental pricing as well as the FUA. If S. 2205 is amended to include incremental pricing repeal, as is certainly the case with Senator Nickles' bill S. 1302, then S. 2205 too would receive A.G.A.'s enthusiastic support.

IV.B.

FUA and Incremental Pricing are Based on Erroneous Economic Assumptions

Congress enacted the FUA and incremental pricing based upon inaccurate and outdated assumptions about the natural gas market. In enacting the FUA in 1978, Congress assumed that the nation's natural gas supplies were declining. Therefore, the FUA was designed to discourage industrial gas use which, in turn, would save remaining gas supplies for residential and other high-priority customers. However, these assumptions since have been proven wrong. Passage of the NGPA in 1978 spurred new gas exploration and production activity in subsequent years. In the 5-year period prior to the enactment of NGPA (1974 to 1978), the amount of gas added to "on the shelf" proven gas reserves in the Lower-48 States was less than half of the amount of gas produced from those reserves. However, in the 5-year period beginning in 1980, after the enactment of the NGPA, additions to gas reserves in the Lower-48 States nearly equalled the amount of gas produced from those reserves. Moreover, in 1985, gas production capability exceeded gas consumption by approximately 2.5 Tcf (gas consumption was slightly under 18 Tcf).

Today, it is recognized that the nation has 50 years of conventional gas resources (i.e., remaining recoverable resources) and hundreds of years of unconventional gas in-place. In short, the nation is not running out of natural gas and restrictions on industrial gas use can no longer be rationalized. Indeed, poor gas demand is a major disincentive to producers already hit hard by declining oil and natural gas prices, and federal tax uncertainty. This disincentive should be removed forthwith.

The economic assumptions upon which incremental pricing are premised have been overtaken by market conditions. In 1978, Congress deemed incremental pricing to be necessary to order the gas market. Incremental pricing was designed to protect price sensitive gas customers by inhibiting pipelines from bidding up the prices for new gas supplies and rolling in this high-priced new gas with their low-priced old gas supplies. Theoretically, the higher prices resulting from "excess bidding" for new gas was imposed on industrial boiler fuel users in the form of a surcharge.9/ Market conditions and state regulatory actions, however, have kept the bidding restraint concept intended in the

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9/ 124 Cong. Rec. H 13114 (daily ed. Oct. 14, 1978) (remarks of Rep. Dingell).

legislation from working at all. Yet, surcharges are frequently being imposed on natural gas, making it less competitive with residual fuel oil.

Actually, Congress quickly recognized that incremental pricing was a bad idea. It had provided for incremental pricing in two phases: Phase I applied only to industrial boiler users, and it is that which remains on the books today; Phase II incremental pricing applied to all other industrial users, and in the NGPA of 1978, its continued applicability was subject to elimination through its rejection by either House of Congress. The House of Representatives indeed rejected Phase II by a 10 to 1 margin.

IV.C.

FUA and Incremental Pricing Cause Economic Inefficiencies

Repeal of FUA and incremental pricing would promote economic efficiency, enhance environmental quality and national security as documented by recent studies conducted by the Urban Institute and the National Defense Council. Both of these studies, which have been distributed to the Congress, document the significant economic and environmental costs of the FUA.

IV.D.

FUA and Incremental Pricing Preclude Opportunities to Lower Consumer Energy Costs

Repeal of FUA and incremental pricing will help the gas industry to expand its industrial market and reduce take-or-pay obligations, thereby lowering prices to gas customers and also to electric customers via more economic generating capability. Gas prices reflect both gas acquisition costs and fixed costs for building and maintaining the gas transmission and distribution system. FUA repeal would allow industrial plant operators and electric utilities to build gas-fired facilities when gas would be the most cost-effective option. Repeal of incremental pricing would help prevent the gas industry from losing more industrial load because of the inhibiting effect of incremental pricing surcharges in the industrial sector. Indeed, FUA and incremental pricing repeal would give the gas industry the opportunity to expand its industrial customer base. Expansion of the gas customer base would permit the allocation of fixed system costs to a larger number of customers. This reallocation of costs would lower the price of gas per customer to reflect a lower percentage of fixed system costs. This is especially true given that customers subject to FUA and incremental pricing are often interruptible or have high load profile consumption factors.

Moreover, because of the current surplus in gas deliverability, increased demand resulting from FUA and incremental pricing repeal should not cause gas commodity prices to increase. In fact, repeal of FUA and incremental pricing and the resultant increase in gas use would reduce take-or-pay obligations for untaken gas. As a result, FUA and incremental pricing repeal potentially could lower gas prices to all consumers.

IV.E.

FUA and Incremental Pricing Exemption Processes Do Not Provide Adequate Relief

Many critics of FUA repeal contend that the FUA exemption process provides ample relief from the prohibitions on gas use. This contention simply is untrue. The FUA exemption process is a major impediment to those plant operators that would like to build a facility that uses gas as the primary fuel source. Moreover, the exemption process for incremental pricing does not provide adequate protection against industrial load loss to imported oil.

The FUA exemption process serves to deter plant operators and electric utilities from using gas in new facilities. One of the benefits from using gas is the short lead time required to construct a gas-fired facility. Indeed, a small scale, prepackaged combined cycle turbine system can be brought on line within one year. Yet, the amount of time that DOE takes to act on a FUA exemption petition can range from 5 to 12 months, thus delaying the installation of a new facility by an additional year.

Indeed, the FUA exemption process has had, and will continue to have, an adverse impact on industrial gas load. More and more industrial users and electric utilities are realizing the benefits of using gas and are applying for FUA exemptions. The number of exemption petitions has increased in recent years: one-third of all of the petitions filed with DOE prior to 1986 were filed in 1985. Yet, the FUA exemption process serves only to delay or preclude industrial gas use. Currently, unresolved DOE exemption petitions have held up 225 Bcf per year of additional industrial gas load, delaying approximately $450 million per year in additional producer revenues. Moreover, many potential projects die in the planning stages because plant operators do not want decisions critical to the operation of their businesses to rely upon a protracted and uncertain federal exemption process.

Industrial gas load probably suffers greater adverse impact from plant operators that refrain from filing for FUA exemptions in the first instance. Those industrial users often are motivated, not only by the delay and uncertainty in the exemption process, but also by the continued and erroneous perception that gas supplies are not adequate to meet long term needs. These problems with the FUA exemption process and misperceptions concerning gas supply only can be corrected by repealing the FUA.

The exemption process for incremental pricing also imposes a significant impediment against the prevention of load loss to oil. Again, factors of time and uncertainty during the process of obtaining an exemption from the imposition of incremental pricing surcharges can actually encourage industrial boiler users to switch to oil. FERC action on the typical petition for incremental pricing relief can take at least 45 days from the date that FERC receives the supporting data. This delay and the accompanying uncertainty about whether relief ultimately will be granted precludes gas companies from having sufficient pricing flexibility to compete with ever-changing oil prices. Thus, the exemption processes for both FUA and incremental pricing are too time-consuming and do not provide adequate relief from the gas demand constraints contained in both statutes.

IV.F.

FUA Inhibits Use of New Technologies

FUA repeal would encourage the use of new gas utilization technologies in the industrial market, such as gas-fueled combined cycle electric power generation and select use of gas in combination with other fuels, that offer high efficiency and environmental benefits. As we indicated earlier, the FUA was designed to discourage industrial energy consumers from using natural gas. An unfortunate side effect of this policy has been to preclude from entry into the industrial market these important new, highly-efficient technologies.

Natural gas-fueled combined cycle turbines allow electric utilities and other industrial users to generate electricity, but with greater efficiency, substantially shorter construction lead times and lower capital outlays than coal-fired or nuclear powerplants. Combined cycle turbine systems are capable of generating electricity up to 50 percent more efficiently than conventional fossil fuel boiler systems. Prepackaged combined cycle systems can be brought on line in 1 to 4 years, while coal-fired or nuclear powerplants are typically brought on line in 8 to 15 years. Finally, combined cycle systems can be built at one-third the capital cost per kilowatt of coal-based capacity and at one-fifth the capital cost per kilowatt of nuclear capacity. Combined cycle turbine systems also are more environmentally benign than steam generating stations. Combined cycle units can be used in conjunction with and can upgrade coal facilities, but FUA restrictions prevent plant operators from making the most economic choice.

Select use of gas (or "select use") in combination with coal, oil or other fuels, as a method of reducing emissions, is another important gas utilization technology that is inhibited by FUA. Natural gas combustion contains virtually no sulfur dioxide or particulates, and far less nitrogen oxides, nonmethane hydrocarbons and carbon monoxide than comparable combustion of other fossil fuels. Greater utilization of select use technology could help reduce sulfur oxides and nitrogen oxides which many believe to be the major contributors to the acid rain problem. However, by discouraging gas use in industrial applications, the FUA inhibits the development of select use technology, which is capable of removing sulfur at $120/ton, one-eighth the cost of a scrubber.

IV.G.

Incremental Pricing Encourages Reliance on Imported Oil

Incremental pricing encourages greater reliance upon imported oil, particularly in light of declining oil prices. In the past, incremental pricing surcharges generally have boosted the price of natural gas to rough parity with the price of No.6 fuel oil. Thus, industrial energy consumers using oil as a boiler fuel were discouraged from switching to natural gas. Today, the posted incremental pricing price has not kept pace with the market due to regulatory implementation and administrative lag, resulting in load loss to oil.

Declining oil prices merely exacerbate the problem of oil import dependence. Since incremental pricing surcharges are calculated based upon oil prices that are 30 to 60 days old, gas prices cannot respond immediately to currently declining oil prices. Thus, incremental pricing could cause gas customers to switch to oil, fostering greater reliance on imported oil.

Natural gas is a readily available, domestic energy source. Our nation's energy supply security would be enhanced if incremental pricing were repealed, removing the disincentive against switching from imported oil to gas.

IV.H.

Incremental Pricing Distorts Market Preferences

Incremental pricing also unnecessarily distorts market preferences for industrial gas consumers. Incremental pricing surcharges are imposed only on gas acquired by interstate pipelines. Gas transported on behalf of industrial users and intrastate gas are not directly affected. Incremental pricing therefore provides an artificial incentive for industrial boiler fuel users to choose transportation over pipeline system sales. These incentives disrupt the market because they are motivated purely on the desire to avoid incremental pricing surcharges rather than on market preferences.

Several Senators on the Senate Energy Committee have previously expressed a desire to support decontrol legislation _if_ all segments of the gas industry can agree on a consensus approach. No such consensus exists. Therefore, it is imperative that these Senators, and the entire Congress, now support stand-alone FUA and incremental pricing repeal.

CONCLUSION

The legislative steps that we are proposing are highly beneficial to natural gas consumers, as well as to the nation's economic, security and environmental policy goals, and to all segments of the natural gas industry. Accordingly Mr. Chairman, we compliment you on holding these hearings and we are hopeful that the Committee will move expeditiously to implement our recommendations.

APPENDIX A

AGA American Gas Association

Planning & Analysis Issues

Issue Brief 86-14 April 11, 1986

ANALYSIS OF A.G.A. LEGISLATIVE APPROACH TO PRICE-CONTROLLED GAS

Introduction

A.G.A. has proposed a method of addressing price-controlled gas (both new and old) in a manner that embraces reduced regulation and greater reliance on market forces. This proposal, which was approved by the A.G.A. Board of Directors, calls for (1) removal of all remaining Natural Gas Policy Act (NGPA) ceilings on new gas (Sections 102d, 103b, 105(b)(3), 107c, 108 and 109), (2) preempting of certain indefinite escalator clauses[1] in existing contracts for new gas (for gas that is deregulated in the previously mentioned sections); and (3) phased removal of ceilings on old gas as existing contracts expire or are renegotiated.

NGPA ceilings on new gas categories still subject to controls are resulting in the price of this gas being roughly twice market levels. By contrast, the price of new gas that was decontrolled on January 1, 1985 has plummeted (see Exhibit 1).

Our analysis indicates that with the current oil price level, decontrol of new gas, along with the phased decontrol upon contract expiration of old gas, could reduce the average interstate pipeline weighted average cost of gas (WACOG) by $0.28 to $0.34/MMBtu by the end of 1986.

Background

Given partial decontrol of new gas on January 1, 1985, the growth of transportation, and the overall instability of energy prices, competition has increased in the energy marketplace. The sudden downturn in oil prices in early 1986 intensified this competition, making it virtually impossible to sell high-cost gas. One indication of this problem is that calculated take or pay obligations of interstate pipelines for untaken supplies of high-cost gas in 1986 could reach $7 billion.[2] Increasing the competitive/take or pay pressure is the continuing gas bubble estimated by A.G.A. at 2.5 trillion cubic feet in 1986.

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In the midst of this market and regulatory chaos, the pressure of rising NGPA price ceilings, which often act as floors, on interstate pipeline WACOGs has intensified. An examination of the trends in gas pricing illustrates the extent to which high cost regulated gas has held WACOGs up. Price-controlled new gas has declined $0.31/MMBtu according to PGA data compiled by Foster Associates since December 1984 -- from $3.78/MMBtu to $3.47/MMBtu by April 1986. In the key section 102d category, average prices declined only $0.09/MMBtu -- from $3.78/MMBtu to $3.69/MMBtu. Decontrolled gas on the other hand, declined $0.87/MMBtu, from $3.97/MMBtu in December 1984 to $3.10 in April 1986 -- with decontrolled Section 102 gas declining $0.89/MMBtu from $3.79/MMBtu to $2.90/MMBtu. The overall pipeline domestic WACOG declined $0.40/MMBtu, from $2.76/MMBtu to $2.36/MMBtu (see Exhibits 1 and 2). Clearly the failure of the price controlled new gas to move downward as fast as the decontrolled gas prevented the WACOG from declining more rapidly. The solution to the current market imbalance should not focus on old gas but must deal with bringing down the price of non-market responsive, price-controlled new gas (often with the most onerous take or pay obligations).

Methodology

Several studies prepared for A.G.A. by Foster Associates illustrate how much gas would be affected by the A.G.A. approach to decontrolling currently price-controlled gas. One study examined prospective production levels for Sec. 104 and 106 gas by contract termination date.[3] The study estimated that about 6% of old gas production is covered by contracts that will expire in each year from 1986 to 1990. Therefore, decontrolling Sec. 104 and 106 gas upon contract expiration would be a gradual process.

Some currently decontrolled new gas is kept above "free market" levels by contract clauses. In order to determine the type of deregulation clauses present in contracts for currently controlled new gas, Foster Associates examined pricing provisions in Sec. 102d contracts (new gas from old OCS leases).[4] The analysis concluded that 65% of Sec. 102d volumes have clauses that set the deregulated price based on the highest area prices (or an average of the highest area prices) with no market out; or have deregulated prices tied to fuel oil prices or other alternatives with no market out. The analysis indicates that indefinite escalator clauses in Section 102d contracts could take the majority of this gas above market levels upon deregulation. In addition, a large number of contracts have price floors tied to the previously regulated prices. Therefore, in order for the A.G.A. proposal to work -- and allow market forces to operate on the newly deregulated gas -- it is necessary to prohibit the use of certain indefinite escalator clauses and floors tied to NGPA ceilings for the new gas categories that would be decontrolled.

To determine what impact decontrol of currently controlled new gas and old gas would have on pipeline domestic gas costs, A.G.A. analyzed several scenarios for 1986 volumes and prices based on data from Foster Associates.[5] These data reflect pipeline PGA filings and may understate or overstate volumes of gas under contract by various NGPA categories. However, the analysis provides a reliable one-year estimate of the impact of the A.G.A. proposal under the stated assumptions. It should be noted that the maximum consumer benefits from the proposal occur in the first year, while old gas is decontrolled in about 6 percent increments every year for ten years.

Results of Analysis

Our analysis is summarized in Exhibit 3. The WACOG from domestic producers is currently $2.36/MMBtu. If no action is taken this year, and the average refinery acquisition crude oil cost averages $18/bbl in 1986, with high sulfur residual oil at $16/bbl (current average prices), the 1986 interstate WACOG is projected to decline to $2.12/MMBtu (Base Case price). This entire decline would be accounted for by currently decontrolled gas (Section 107, 102c, some 103), which is the gas best able to respond to downward market pressure on gas prices. (For purposes of this projection, currently decontrolled gas is assumed to retain its current ratio vis-a-vis crude oil prices.)

Under the A.G.A. proposal, currently controlled Sec. 102, 103, 105(b)(3), 107, 108 and 109 gas would be decontrolled. Due to the influence of contract pricing terms, there is some uncertainty as to just how far the price of this gas would fall if decontrolled. Therefore, two cases have been estimated.

In the Pessimistic Case we assume that some of this gas, while decontrolled, is kept above "free market" levels by contract clauses (including price floors). These non-market responsive contract clauses were assumed to occur in the same proportion as for decontrolled new gas. Under this scenario, the price of currently controlled new gas would drop to the projected price level of currently decontrolled gas. The WACOG would decline to $1.84/MMBtu.

In the Optimistic Case, we assume that upon decontrol, market forces could cause a decline in the price of currently controlled new gas to a "free market" surrogate price, including severance taxes and gathering charges, of 57% of the crude oil price. With a crude oil price of $18, this free market surrogate price is $1.77/MMBtu. This level, which is used in the current A.G.A.-TERA Base Case, is reflective of the relationship between published spot market, transportation, contract prices and crude oil prices in late 1985 and early 1986.[6] The WACOG under the optimistic proposal would decline to $1.78/MMBtu.

In both cases the slight price rise due to gradual decontrol of old gas would be offset by the reduction in prices of above-market-priced contracts. Again, this is a first year result. The decontrol of old gas in small increments would continue to exert upward pressure on prices over a ten year period.

Conclusion

Our analysis indicates that gas prices (and concomitantly take or pay obligations), would be lower with full decontrol of new gas and phased decontrol of old gas.

---

1. Certain indefinite escalator clauses in existing contracts for new gas deregulated under this proposal would be defused. Specifically, price determination clauses based on other gas prices (favored nation clauses), oil prices or NGPA ceiling prices would be made inoperative. If because of this prohibition, no price determination clause remained in the newly deregulated gas contract and the parties could not agree to new terms, then the seller would be guaranteed access to the nearest major interconnect.

2. A.G.A., Take or Pay Payments and Obligations (Issue Brief 86-8, March 7, 1986).

3. Foster Associates, Inc., Analysis of NGPA Sections 104 and 106 Gas Purchases by Contract Termination Date (August, 1983).

4. Foster Associates, Inc., Deregulated Pricing Provisions in Interstate Natural Gas Contracts Covering Sales of New Gas from Old OCS Leases (April, 1986).

5. Foster Associates, Purchased Gas Costs of Interstate Pipeline Companies (monthly).

6. A.G.A., A.G.A.-TERA Base Case 1986-1 (January 17, 1986).

EXHIBIT 1

TRENDS IN NEW GAS COSTS

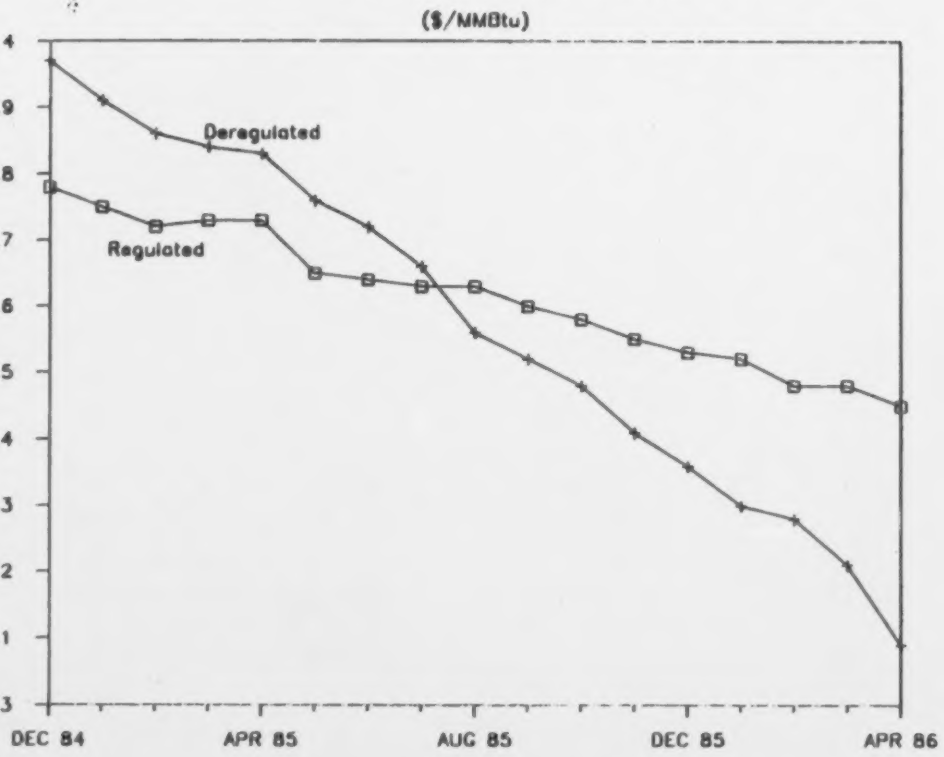

EXHIBIT 2

AVERAGE GAS COSTS BY NGPA CATEGORY

($/MMBTU)

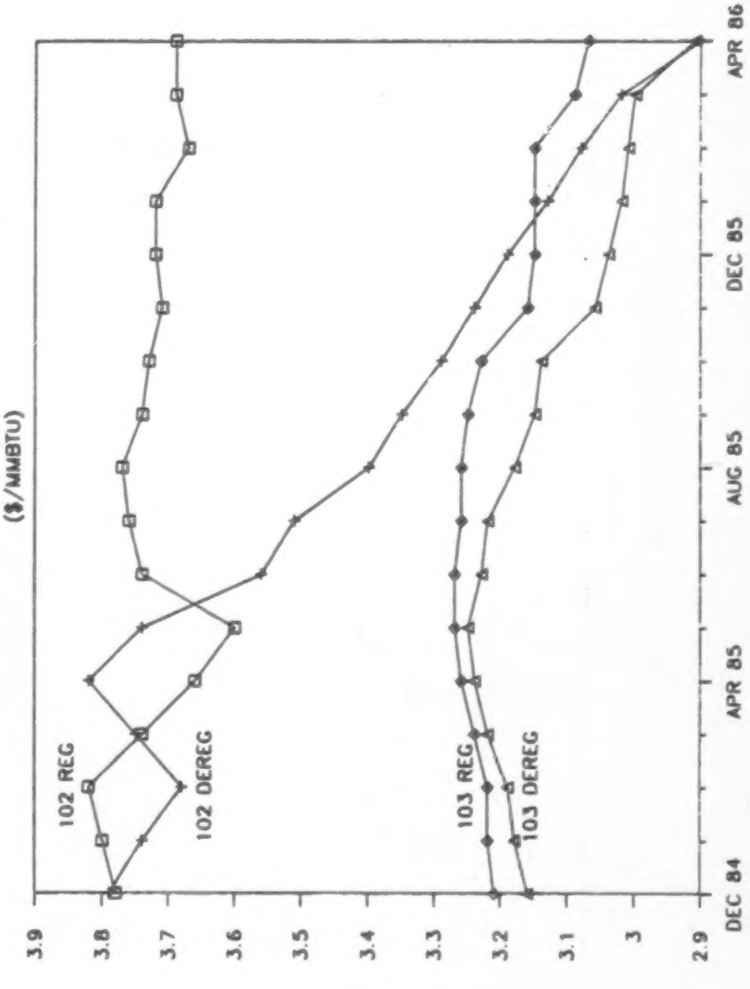

EXHIBIT 3

DECONTROL OF CURRENTLY CONTROLLED GAS

NGPA Category	April 1986 Volumes (% of Total)	April 1986 Price ($/MMBtu)	Base Case 1986 Price[1]	New 1986 Price	
				Pessi-mistic[2]	Opti-mistic
CURRENTLY DECONTROLLED					
102	20%	$2.90	$2.08	$2.08	$2.08
103	7	2.91	2.02	2.02	2.02
107	5	4.17	2.85	2.85	2.85
(Subtotal)		(3.10)	(2.19)	(2.19)	(2.19)
CURRENTLY CONTROLLED					
102	10%	$3.69	3.69	2.08	1.77
103	5	3.07	3.07	2.02	1.77
107	2	3.30	3.30	2.08	1.77
108	3	3.76	3.76	2.08	1.77
(Subtotal-Controlled New)		(3.50)	(3.50)	(2.06)	(1.77
104/106	38%	$1.39	1.44	1.46	1.46
(Subtotal-Controlled)		(2.12)	(2.15)	(1.67)	(1.57
OTHER	10%	1.66	1.70	1.70	1.70
DOMESTIC WACOG	100%	2.36	2.12	1.84	1.79

GENERAL ASSUMPTIONS:
Refinery acquisition crude oil cost at $18/bbl ($3.10/MMBtu) in 1986; 1985-1986 inflation of 3.3%.

[1] **BASE CASE 1986 PRICES WITH $18/bbl OIL:** (no new gas decontrol)
Currently decontrolled gas in same proportion to crude as in 1985. Controlled Section 104/106 gas escalated at inflation rate. All other controlled gas held constant. "Other" gas escalated at inflation except warranty gas held constant.

1986 PRICE RESPONSE TO NEW GAS DECONTROL:

[2] **Pessimistic Case** (contract clauses hold prices above free market price)
Section 102, 107 and 108 controlled price goes to Section 102 decontrolled price.
Section 103 controlled price goes to Section 103 decontrolled price.
Section 104/106 controlled price: 6% rises to market level (57% of Crude); 94% unaffected.

[3] **Optimistic Case** (achieves free market price)
Section 102, 103, 107 and 108 controlled price = 57% of Crude oil pric
Section 104/106 controlled price same as for pessimistic case.

APPENDIX B

American Gas Association

Planning & Analysis Issues

Issue Brief 86-8 March 7, 1986

TAKE OR PAY PAYMENTS AND OBLIGATIONS

Background

The issue of take or pay payments and take or pay liability has been a focal point of debate in the regulatory and legislative arenas. Some parties have claimed that the take or pay problem has been solved; while others see it as the principal problem impacting gas markets today. In the past, take or pay issues have been "settled" (postponed) through waivers, trading take or pay relief for access and payments. The ability to continue these terms of accommodation has been severely curtailed by rapidly falling oil prices and Order 436. The stated reluctance of interstate pipelines to participate in Order 436 transportation as well as the imbalance in the price of system gas at $2.43/MMBtu (interstate pipeline WACOG's) and spot market gas ($1.80-$2.00/MMBtu) have been attributed to take or pay requirements in high priced contracts. The purpose of this issue paper is to quantify the take or pay problem -- historical, current, and projected.

Results

Take or pay payments (pre-payments for gas under contract not taken) by interstate pipeline have increased substantially from $51.6 million in 1977 to $1.148 billion in 1984 as reported in Statistics of Interstate Natural Gas Pipeline Companies, EIA (Figure 1). While this latter number is large relative to the total annual purchases of domestic gas by interstate pipelines (estimated at 8.4 Tcf in current PGA's), potential liability for untaken gas has increased at a much greater rate.

As reflected in the analysis and assuming all deliverability to be subject to take or pay, based on contracted-for proved reserves and historical reserve to deliverability ratios, interstate pipeline obligations for untaken gas probably reached $4.95 billion in 1985. In 1986, given the sharp decline in oil and spot market gas prices, as well as the projected purchase volumes in filed PGA's, this liability (exposure) could jump to $7.29 billion (Figure 2).

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- Interstate pipeline proved domestic reserves under contract have remained relatively stable in the 1980's -- declining only 5.6% from 83.6 Tcf in 1981 to 79.9 Tcf in 1984 (see Table 2). Over this period production capability (deliverability) -- the criteria upon which take or pay is most often based -- has remained absolutely flat (11.0 Tcf in 1981 and 11.1 Tcf estimated in 1986). As a result of a number of factors, including in-fill drilling, well repacking and other production enhancement techniques, the ability to produce at lower and lower R/P ratios has improved (see Tables 2 and 5).

- During this period of flat deliverability, requirements by interstate pipelines for domestic gas under long-term contracts has declined significantly from 10.9 Tcf in 1980 to an estimated 8.4 Tcf in 1986 (23% decline). See Table 4. The principal reasons for this decline are: (1) a contraction in the size of U.S. gas requirements; and (2) a displacement of systems gas by transported gas. The transported gas does not generally provide a credit for pipelines against take or pay obligations.

- While the precision of the exact extent of the take or pay exposure can be debated -- particularly on the issues of oil price and carriage volume assumptions as well as the extent of take or pay renegotiation/waiver -- the underlying methodology in this analysis is conservative. The analysis uses estimated PGA volumes for 1986 as of PGA's effective January 1, 1986. PGA's on file for the period starting March 1, 1986 estimate annualized volumes of 7.7 Tcf (8.3% lower than the January estimate - potentially affected by seasonal factors). Thus the potential problem appears to be worsening due to effects of the spot market and declining oil prices.

Methodology

The calculation of take or pay payments was based on data for interstate pipelines taken from FERC Forms 2 and 15. The estimate of the dollar amount of interstate obligations for untaken gas was based on a comparison of production capability under contract versus the amount of gas actually taken.

The trends in R/P ratios for long term interstate contracts with producers show a steady increase in production capability (decline in R/P ratio) prior to 1981 when the minimum R/P ratio was recorded. These statistics are shown in Table 1. For this study it was assumed that this decline would continue, increasing the deliverability of the committed reserves. The assumed R/P ratios (indicating a continuation of the historical trend) are tabulated as the Interstate deliverability capability in Table 1. The calculations are based on the declining reserves (assumed to decrease at 0.4 Tcf per year) and the declining reserves to deliverability ratio (assumed to decline at a rate of 0.1

per year). These parameters are the basis for the estimate of "optimal production level" or production capacity listed in Table 5. Actual production is subtracted from the "optimal production level" to determine the quantity of gas which would have been produced but was shut-in for lack of demand. This volume is indicative of take-or-pay obligations (liability) being accrued by interstate pipelines.

This analysis does not consider Canadian take or pay liability; only the domestic U.S. liability is estimated. Nevertheless, take or pay obligations to Canadian producers would increase the dollar and volume levels estimated.

Table 1
Reserves to Production Ratios

Year	All Interstate		Columbia	Panhandle	United
	Actual	Capability			
1963	19.4				
1965	18.0				
1967	16.3				
1969	13.6				
1971	11.1				
1973	9.6				
1974	9.1		7.03	8.69	5.36
1975	8.5		6.88	9.66	4.10
1977	8.3		6.47	9.41	3.71
1978	8.2		6.09	8.70	3.84
1979	7.8		6.15	8.78	3.60
1980	7.8		6.50	8.73	3.17
1981	7.7	7.6	6.34	8.05	3.75
1982	8.3	7.5	6.93	10.02	4.58
1983	9.3	7.4	7.45	12.98	6.35
1984	8.1	7.3	6.49	10.92	4.65

SOURCE: Gas Supplies of Interstate Natural Gas Pipeline Companies 1984, EIA.

Table 2
Production Calculations (in Tcf)

Year	Reserves at Y.E.	Production Capability	Actual Production	Unused Production[1]
1981	83.6	83.6/7.6 =11.0	10.9	0.1
1982	84.4	84.4/7.5 =11.3	10.2	1.1
1983	83.3	83.3/7.4 =11.3	9.0	2.3
1984	79.9	79.9/7.3 =10.9	9.9	1.0

[1] Insofar as this potential production is under contract, there could be a take-or-pay liability associated with it.

Table 3
Liability Calculations

Maximum liability for 1981-1984 in dollars would be:

1981 ($2.05) (0.1) = $ .21 billion

1982 ($2.60) (1.1) = $2.86 billion

1983 ($2.81) (2.3) = $6.46 billion

1984 ($2.80) (1.0) = $2.80 billion

Table 4
Interstate Supplies Analysis (in Tcf)

	Interstate Pipeline Supplies				
Year	Total	Imports	Company Owned	Long-Term Contracts	Short-Term And Emergency
1980	12.6[1]	1.0[1]	.7[1]	10.9[1]	-
1981	12.8[1]	.8[1]	.6[1]	10.9[1]	.4[1]
1982	11.3[1]	.9[1]	.6[1]	10.2[1]	.1[1]
1983	10.4[1]	.9[1]	.4[1]	9.0[1]	.1[1]
1984	11.2[1]	.8[1]	.4[1]	9.9[1]	.2[1]
Projected					
1985	10.5[2]	.9[3]	.4[4]	9.2	-
1986	9.8[2]	1.1[4]	.3[4]	8.4	-

[1] *Gas Supplies of Interstate Natural Gas Pipelines*, EIA.
[2] Estimated from Volume of Purchased Natural Gas by Major Interstate Pipelines, *Natural Gas Monthly*, EIA.
[3] *Monthly Energy Review*, EIA.
[4] Estimated.

Table 5
Estimate of Future Take or Pay
(Tcf)

Year	Interstate Reserves at Y.E.[1]	Production Capacity[2]	Long-Term Contract Production[3]	Unused Production
1985	79.5	11.0	9.2	1.8
1986	79.1	11.1	8.4	2.7

[1] Assumes average decline in last seven years, i.e., -0.4 Tcf per year.
[2] Assumes R/P = 7.2 in 1985 and 7.1 in 1986 as maxmimum production capability.
[3] As derived in Table 4.

Table 6
Take or Pay Liability

	Pipeline Reports[1]		Maximum Production Capability	
Year	Gas Prepayments (Million $)	Undelivered Gas (Bcf)	Gas Volumes (Tcf)	Gas Costs (Millions $)
1977	$ 51.6	160.3	As reported by Pipelines	
1978	$ 69.0	154.1	As reported by Pipelines	
1979	$ 110.9	163.8	As reported by Pipelines	
1980	$ 223.6	499.2	As reported by Pipelines	
1981	$ 346.6	252.5	0.1	$ 210
1982	$ 821.6	450.9	1.1	$2,360
1983	$1,100.6	502.8	2.3	$6,460
1984	$1,148.0	499.5	1.0	$2,300
1985	-	-	1.8	$4,950[2]
1986	-	-	2.7	$7,290[3]

[1] *Statistics of Interstate Natural Gas Pipeline Companies*, EIA.
[2] Price of shut-in gas assumed to be $2.75/Mcf.
[2] Price of shut-in gas assumed to be $2.70/Mcf.

FIGURE 1

ANNUAL TAKE OR PAY PAYMENTS

($ millions)

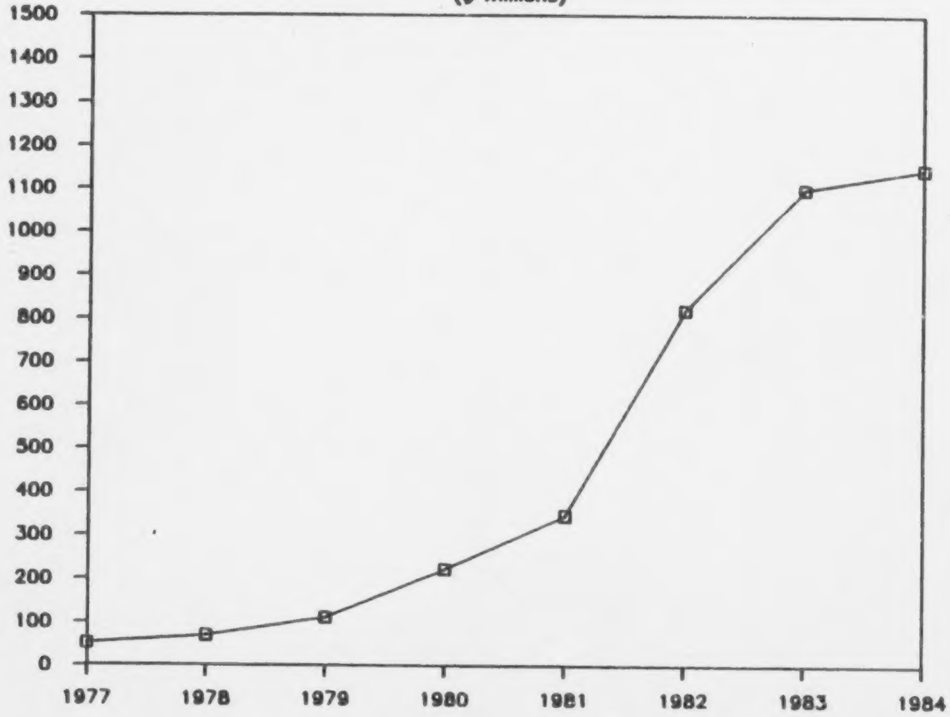
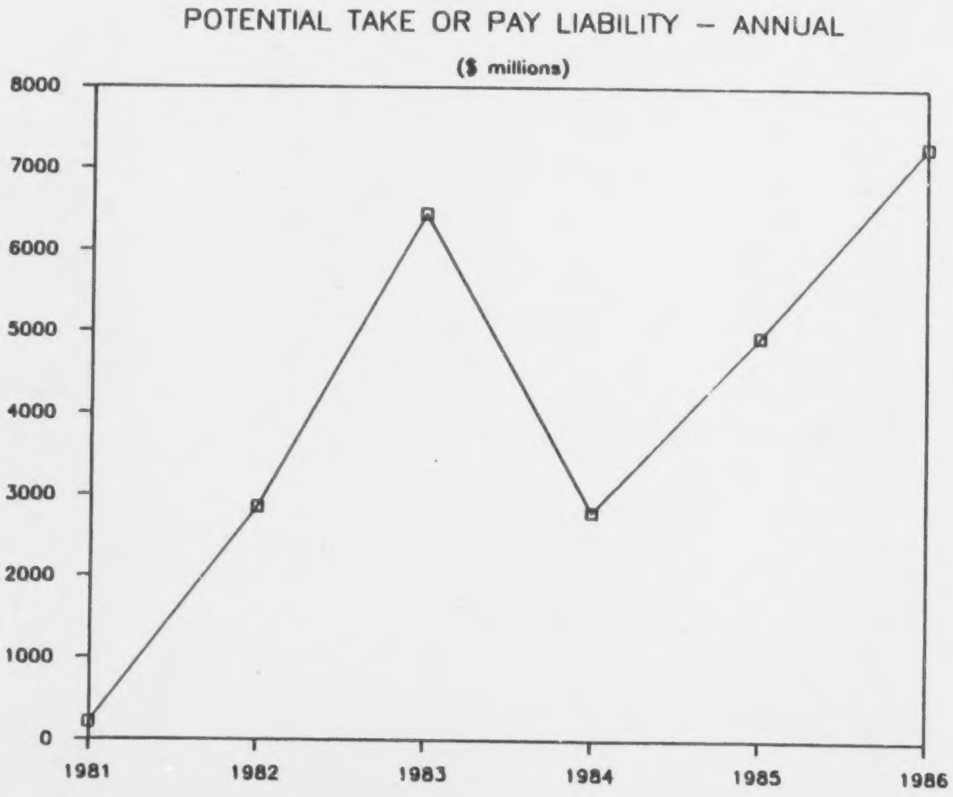


FIGURE 2


POTENTIAL TAKE OR PAY LIABILITY – ANNUAL
($ millions)
8000
7000
6000
5000
4000
3000
2000
1000
0
1981
1982
1983
1984
1985
1986

APPENDIX C

AGA American Gas Association

Planning & Analysis
Issues

Issue Brief 86-16 May 1, 1986

TAKE OR PAY PAYMENTS AND OBLIGATIONS

Background

The issue of take or pay payments and take or pay liability has been a focal point of debate in the regulatory and legislative arenas. Some parties have claimed that the take or pay problem has been solved; while others see it as the principal problem impacting gas markets today. In the past, take or pay issues have been settled or postponed through waivers, trading take or pay relief for access and payments. The ability to continue these terms of accommodation were curtailed by the open access provisions of Order 436. The imbalance in the price of system gas at $2.43/MMBtu (interstate pipeline WACOG's) and spot market gas (about $1.50/MMBtu) have been attributed to take or pay requirements in high priced contracts. The purpose of this issue paper is to quantify the take or pay problem.

Conclusions

A.G.A. reviewed the gas industry take or pay problem in Issue Brief 86-8 dated March 7, 1986 and in testimony to FERC dated April 10-11. In the first analysis it was established that take or pay liabilities could reach $7.2 billion in 1986 absent any settlements or renegotiation. The analysis concluded that the problem was large and increasing in magnitude. The FERC testimony was based on data from Annual Reports to shareholders which quantified the year-end 1985 liability at $6.2 billion.

Certain major gas producers have stated that most take or pay obligations have already been settled; while the Natural Gas Supply Association (NGSA) reviewed selected annual reports of major interstate pipelines for year-end 1984 and 1985 and concluded that the total liability was about $4.9 billion but that about $3.6 billion of that liability had been settled. This assessment of take or pay liability was reported to the FERC by NGSA. This paper includes some of the data from key pipelines omitted by NGSA and demonstrates that the NGSA assessment understated the liability by a very wide margin.

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EIA, in an April 1986 report requested by Congressman John D. Dingell, Chairman of the House Committee on Energy and Commerce, evaluated the take or pay liabilities of major interstate pipelines. The EIA study concluded that a $3.6 billion liability was outstanding at year-end 1984 and that by year-end 1985...."at least $5.7 billion remained unresolved...." As shown in Table 1, the EIA data correlate well with the A.G.A. report.

Data Comparisons

Many of the major gas pipelines reported take or pay liabilities in their year-end 1985 Annual Reports to shareholders. These reports have been the primary source of information by which the take or pay liability has been quantified. Annual Reports provided the primary information on take or pay liabilities for A.G.A., NGSA, and EIA.

The NGSA reported in Exhibit 1 of their filing to the FERC a combination of 1984 and 1985 data from nineteen pipelines. Six of these pipelines were reported by NGSA to have no liability stated. The NGSA data accounted for $4,876 million of total liability. In Exhibit 3 of the NGSA filing NGSA accounts for $3.6 billion of settlements which presumably would be subtracted from the $4.8 billion of liability.

These NGSA calculations which were based on data at year-end 1984 and 1985, excluded several important pipelines (e.g., Tennessee Gas Pipeline Company which reported a $2 billion liability was listed as not stating any liability) and the values reported in Exhibit 1 were not directly related to the settlements reported in Exhibit 3. In fact, year-end liabilities listed in annual reports were by definition remaining liability after settlements made during the year.

In an effort to clarify what was actually reported by the pipelines and to provide a documentation of those reports not included in the NGSA report, A.G.A. assembled the data reported by NGSA, EIA and A.G.A. in Table 1. Instead of illustrating a non-existent take or pay problem as suggested by the NGSA report, the take or pay liability at year-end 1985 was quantified at approximately $6.2 billion by A.G.A. and at least $5.7 billion by EIA. Earlier A.G.A. studies showed that this liability was large and increasing.

In contrast to the A.G.A. and EIA results, NGSA concluded that a much lower take or pay existed by omission of HNG/InterNorth, United Texas and Tenneco and listing significantly reduced liabilities from older and out-dated reports for MidCon and Northwest. However, if the more recent data from annual reports and 10K filings are tabulated, the take or pay liability for these major pipelines is about $6.2 billion.

Take or Pay Estimates (in $millions)

	A.G.A. Report			Other Reports	
Company	Liability	Report	Date of Report	EIA	Exhibit 1, NGSA
Coastal Corp.	$176.8	Annual p.34	March 14, 1986	-	1984 data reported
HNG/InterNorth	$125	Annual p.48	March 1986	$ 125	Not included
MidCon					
Natural Gas Pipeline of America	$150	10-Q p.11	February, 1986	$ 150	Listed as $11 million
United Gas	$572	Annual pp.38-39	November 8, 1985	$ 401[1]	Listed as $467 million
United Texas	$123			-	Omitted
Northwest	$75	10K p. 28	January 1986	$ 75	Listed as $5 million
Northwest Central	$35	10K p.p. 26,27	January 1986	$ 35	Listed as $60 million
Panhandle Eastern	$800	Annual p.48	February 12, 1986	$1,500	Correctly listed
Trunkline	$700				
Southern Natural	$700	Annual p.38	February 27, 1986	$ 700	Correctly listed
Tenneco	$2,000	Annual p.42	March 19, 1986	$2,000	Omitted
Texas Gas Transmission	$105	Annual p.30	January 1986	-	Correctly listed
TRANSCO	$675	Annual p.60	March 4, 1986	$ 675	Correctly listed
TOTAL:	$6,236.8			$5,661	

[1] EIA noted that this was liability was reported as of February 6, 1986. United reported an additional $137 liability for Sea Robin.

NOTE: Natural Gas Pipeline of America and Northwest liabilities were based on 10Q and 10K reports.

APPENDIX D

AGA American Gas Association

Planning & Analysis Issues

Issue Brief 1986-18 May 9, 1986

CRITIQUE OF DOE ANALYSIS OF THE NATURAL GAS POLICY ACT AMENDMENTS OF 1986

The Office of Policy, Planning and Analysis of the U.S. Department of Energy has released an analysis, dated April 1986, of the Administration's proposed gas decontrol legislation.[1] The Administration bill would immediately decontrol the price of any gas subject to contracts executed or renegotiated after March 1, 1986 and would decontrol all other gas on April 1, 1987. In addition, it would require mandatory, non-discriminatory pipeline carriage and would repeal the Fuel Use Act and incremental pricing.

DOE's analysis of its proposal concludes that the proposal would (1) reduce consumer gas prices while increasing the price of old gas, and (2) eliminate the gas surplus while at the same time increasing gas supplies by 5%.

Not only are these conclusions contradictory, they are also unsupported by the analysis.

While DOE argues correctly that many natural gas prices are too high given current market conditions (e.g., the persistent gas surplus), the proposed solution is to encourage contract renegotiation by increasing the surplus. DOE estimates that its decontrol proposal would increase gas supplies by 5% annually. In turn, "increased gas supplies would exert downward pressure on gas prices."[2] Not only does DOE fail to address the question of why a 5% increase in the gas surplus would achieve competitive gas pricing that the seven-year-old gas surplus has failed to achieve, their estimates of the production increase are based on faulty methodology that has been repeatedly and thoroughly discredited.[3]

DOE believes that by increasing old gas prices to market levels, production of old gas would be increased in three ways:

- delayed abandonment of producing wells,
- increased infill drilling, and
- increased use of production enhancement (well stimulation) techniques.

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The DOE analysis claims that "additional production of old gas will provide economic benefits immediately."[4] It then proceeds to contradict this statement in Appendix B.

With regard to delayed abandonment, DOE estimates that a market price of \$2.70 - \$3.00 per million Btus would be required to give the production increases claimed.[5] DOE's price projections indicate that these prices will not be achieved before the 1990s.[6]

With regard to infill drilling, DOE specifically states that "infill drilling will not begin before the early 1990s.[7] Likewise, DOE states that the prices needed to justify additional production enhancement will not be attained before 1992.[8]

DOE's own analysis, therefore, indicates that any reserves increases from old gas decontrol will not occur before the early 1990s -- contradicting its statement that an immediate 5% increase in production would occur from old gas decontrol.

Moreover, DOE fails to acknowledge that fully one-quarter of all old interstate gas (Section 104c) is now priced above market levels. The analysis does not discuss the supply implications of lowering the price of this gas (or above-market new gas and stripper well gas) to market levels.

Past experience shows that contracts for high-priced gas, where no market-outs on similar price redetermination clause exists, have failed to respond to the gas surplus over the past several years. It is therefore illogical to assume that the raising of old gas prices in isolation would lower these new gas prices. DOE merely states as an article of faith that "in a fully decontrolled market, these contracts would be renegotiated."[9]

In reality, nothing in the DOE proposal would force the renegotiation of non-market-responsive contracts. By definition, such contracts do not respond to market forces. The DOE analysis itself acknowledges that many contracts for both "old" gas and "high-cost" gas (which now includes some old gas, e.g., Section 104c) contain deregulation clauses that would prevent the contract price from declining upon decontrol, and might actually raise the contract price even farther above market levels. A recent survey of old gas contracts by DOE's Energy Information Administration (EIA) concluded that "very few old interstate gas contracts contain provisions that would easily allow them to be market-sensitive... Either voluntary renegotiation of contracts or other actions may be required to achieve the full benefits of deregulation" (emphasis added).[10]

The DOE decontrol proposal contains no measures to prevent contract prices from rising above market levels if required under existing contracts. However, it treats another category of contracts very differently. Some gas is currently being purchased by pipelines under contracts with area rate clauses (i.e., price tied to regulated ceiling levels) and specified low fixed prices if the ceilings are abolished. DOE is concerned that "the contract price could fall to the base contract price, in some cases as low as

$0.50/Mcf."[11] DOE therefore proposes that such contracts be abrogated so as to retain the most recent price paid (pre-decontrol) under the contract. Apparently, DOE is willing to abrogate contracts that would otherwise result in gas prices declining.

The EIA study cited previously estimated that "gas priced below market levels because of contracts that would revert to very low base prices upon deregulation (constitutes) at most 30 percent of old interstate gas and probably much less."[12]

Significantly, not all gas affected by this measure would be low-cost gas. For example, the highest-priced old gas (Section 104c) is currently receiving prices of $2.60/MMBtu, far above the interstate pipeline weighted average cost of gas (WACOG) of $2.31 and even farther above spot market prices, which are often below $1.50/MMBtu today.[13] Clearly, in the case of Section 104c contracts without renegotiation provisions, the DOE proposal would retain prices above market levels.

Furthermore, contracts for high-priced gas that have no renegotiation clause would also be affected by this provision. Section 108 gas with no renegotiation provisions would be kept at its current average price of $3.75/MMBtu, Section 102 (d) gas at $3.67 and gas from tight sands at $3.18.

DOE is proposing a curious form of contract abrogation that would maintain some gas prices above market levels. On the other hand, DOE proposes no legislative relief for gas under contracts that already call for above-market prices upon decontrol. By failing to deal with these issues in a balanced manner, the DOE analysis gives faulty and misleading results. Any legislative initiative based on such an erroneous analysis can only obstruct efforts to achieve truly competitive gas pricing.

Summary of Results

(1) The alleged short-term supply response to old gas decontrol (5% production increase) upon which DOE's estimated consumer and economic benefits are based are shown not to exist in the text of the report.

(2) The DOE assumption of massive renegotiation of high priced contracts to lower prices as a result of old gas decontrol is unsupported by data or analysis -- and events of the last two years have tended to show this assumption to be incorrect.

(3) While purporting to believe that market forces alone will bring down the price of high priced new gas, the DOE legislation (and analysis) advocates contract abrogation in areas where contract terms would lower gas prices upon decontrol. The DOE position regarding legislative overriding of contract provisions that would lower gas prices shows an underlying belief that contract terms can indefinitely resist market forces.

FOOTNOTES

[1] U.S. Department of Energy, Office of Policy, Planning and Analysis, *The Natural Gas Policy Act Amendments of 1986*, DOE/PE-0074, April 1986.

[2] *Ibid.*, p. 43.

[3] See, for example, American Gas Association, *Fact Sheet: Shell Oil Study of 'Increase in U.S. 'Old Gas' Reserves Due to Proposed Rulemaking Eliminating Vintaging*, Issue Brief 86-11, March 19, 1986.

[4] U.S. Department of Energy, p. 35.

[5] *Ibid.*, Appendix B, p. 12.

[6] *Ibid.*, pp. 55-56.

[7] *Ibid.*, Appendix B, p.13.

[8] *Ibid.*, Appendix B, p. 15.

[9] *Ibid.*, p. 21.

[10] U.S. Energy Information Administration, *An Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas*, February 1986, p. 55.

[11] U.S. Department of Energy, p. 45.

[12] U.S. Energy Information Administration, p. 54.

[13] Foster Associates, Inc. *Current Purchased Gas Costs of Interstate Pipeline Companies*, April 24, 1986.

TABLE 1

COMPANIES FILING FOR ORDER 436 BLANKET CERTIFICATE

		Docket No.	Date Filed	Date of Order
1.	Gas Gathering Corp	CP86-129	11/01/85	12/05/85
2.	Valley Gas Transmission	CP86-171	11/05/85	11/29/85
3.	Mid Louisiana Gas	CP86-214	11/26/85	02/11/86
4.	Columbia Gulf Transmission	CP86-239	12/13/85	02/25/86
5.	Columbia Gas Transmission	CP86-240	12/13/85	02/28/86
6.	Ozark Gas Transmission System	CP86-250	12/24/85	Pending
7.	Gas Transport, Inc.	CP86-291	01/24/86	Pending
8.	Valero Interstate Transmission	CP86-300	01/30/86	Pending
9.	Consolidated Gas Transmission	CP86-311	02/10/86	Pending
10.	Erie Pipeline System	CP86-330	02/14/86	Pending
11.	Transylvania Gas Pipeline	CP86-334	02/14/86	Pending
12.	Seagull Interstate	CP86-364	03/07/86	Pending
13.	Texas Eastern Transmission	CP86-379	03/13/86	Pending
14.	Superior Offshore Pipeline	CP86-387	03/17/86	Pending
15.	Northern Border Pipeline	CP86-395	03/19/86	Pending
16.	Transco Offshore Gathering	CP86-397	03/20/86	Pending
17.	Transcontinental Gas Pipe Line	CP86-405	03/28/86	Pending
18.	Northern Natural Gas	CP86-435	04/11/86	Pending
19.	Washtenaw Pipeline	CP86-445	04/15/86	Pending
20.	Standard Gas Marketing Company	CP86-449	04/16/86	Pending
21.	Transco Gas Services, Inc.	CP86-452	04/17/86	Pending
22.	Moraine Pipeline Company	CP86-492	05/12/86	Pending

Note:

a) El Paso Natural Gas intends to file for a blanket certificate in accordanc with Order 436 upon FERC approval of El Paso's offer of settlement, filed March 21, 1986.

b) Transwestern will file for a blanket certificate as soon as a settlement between Transwestern and its customers is approved by FERC. The settlemen was filed with the Commission on January 16 and was certified to the Commission as uncontested on March 24, 1986.

5/15/86

Senator NICKLES. Mr. Lawrence, thank you very much for your appearance again before our committee.

For our next panelist we have Mr. Porter, director of hydrocarbon supply department, Union Carbide.

STATEMENT OF E.E. PORTER, DIRECTOR, HYDROCARBON SUPPLY DEPARTMENT, UNION CARBIDE CORP., ON BEHALF OF THE PETROCHEMICAL ENERGY GROUP

Mr. PORTER. I am appearing on behalf of the Petrochemical Group, and I ask that the full testimony be submitted in the record. I will summarize my remarks.

Senator NICKLES. Thank you.

Mr. PORTER. First and most importantly, thank you, Senator, and Senator McClure, for holding this hearing and having the courage at a time when we do not have an energy crisis and the foresight to address comprehensive natural gas legislation. We believe the cornerstone of any reform of the natural gas situation is the removal of Federal price and allocation controls.

The cushion of the lower cost of regulated gas supplies is the root cause of the problems in the gas industry, whether in times of shortage or in the case that we have today before us, in times of surplus, that surplus really being not a surplus of supply, but rather a problem associated with demand. I will agree with my friend, Mr. Lawrence, in that regard.

Until the cushion problem is resolved, the Congress will be plagued with requests for special relief of one kind or another as piecemeal adjustments are sought. As you pointed out in your opening remarks, Senator, whether we like it or not, the Congress was responsible for the Natural Gas Act and the Natural Gas Policy Act, and it is, I think, a tribute to you and others that you are not ducking the congressional responsibility to try to mitigate the problems that we have with comprehensive legislation.

Now, you have heard, I think, kind of in a classic way from the other people that have testified that we have a problem that on the industrial user side we call gridlock, and I would like to address just quickly what we see is the cause of the gridlock and what some potential solutions are. The three major sectors that have already testified, the producer, the pipelines, and the distributors, are really the cause of the gridlock.

There appear to be four major issues, as you have heard, leaving aside for the moment the issue of contract carriage, which Mr. Merrels will address. First, Federal restrictions on the sale of gas to a new purchaser when the wellhead contracts expire or are terminated, commonly called the abandonment or right-of-first-refusal problem. Second, Federal price controls that can operate to restrain or to operate as a price support for gas prices at the wellhead.

Third, contracts that call for the payment of the maximum lawful price established by Congress—I underline again, by the Congress, or by Federal Energy Regulatory Commission under NGPA, or for payment based on the agreement of the parties, commonly called by some the nonmarket-responsive contract problem.

And fourth, whether the producer, the pipeline, or the distributor should pay the cost of holding gas supplies shut in the ground, commonly called the take-or-pay problem, and often recently more focused to say caused by poor planning or the inability to project what the weather is going to do, what the user is going to do, what the price of oil is going to do.

Even when segregated and isolated in this manner, it is apparent that the issue is the same, price and access to supply. These are all driven by Federal controls. Now, there was a comment earlier about what the effect has been in the marketplace as a result of partial decontrol. I think Secretary Herrington was asked whether or not the price of forever regulated gas, 102 OCS gas was above market clearing levels. I would like to point out that indeed that is true, and it has also been our experience that as a result of partial decontrol, that we saw prices of 102 gas come down, contrary to what Dr. Cooper said.

I point out to you that in the last 30 years there has only been occasional times when both gas and oil has been deregulated in the same market, and that is in the intrastate rather than the interstate market. So we do not have any experience to really know what happens when you have full deregulation of gas and you have got both gas to gas and gas to other fuel competition.

Now, we respectfully suggest that the termination of the Federal controls would lead to a rationalization of the situation far better than any other alternative, and we do not support the notion of a bailout of the take or pay problem. The solution might be painful for some. The status quo is painful for some. But we would prefer status quo to a piecemeal resolution.

The other suggested solution, reimposition of some form of Federal controls on contracts, would be painful as well, but by allowing renegotiation, with all four of the issues on the table, offers the best hope, we feel, of all the options. This requires termination of price and allocation controls. It is that simple.

What happens if Federal regulation of the sale of gas at the wellhead is removed? First, contracts between the parties will control according to the terms that were originally negotiated. Second, where there are no contracts, gas may be sold to any potential purchaser without prior approval of the FERC or to prior purchaser. Some will object to both results. Some will say that the parties should not be permitted to live under private contracts. Some will even argue for the abrogation of contracts by the government, as has been suggested earlier. They will argue that the price of gas at the wellhead will increase substantially over the status quo.

Well, if we had decontrol, what will the average price be? It could go up. It could go down. It could stay the same. Secretary Herrington related the DOE view that prices would go down. Our experience, as I pointed out, with 102 gas after partial decontrol in intrastate markets where they were free of regulations was that they would go down. Now, we are willing in tough times, as industrials, to assume the risk that prices might go up, and we think that other consumers should be willing to take that risk, too, because in the long run competition both from gas and from other sources of energy should induce a rational behavior by all sectors of the gas industry, the producer, the pipeline, and the distributor.

How long will the rationalization process take? The answer to that lies in whether or not the Congress gives to FERC the power to require that available capacity on interstate lines be opened to all shippers and then used on a nondiscriminatory basis, and Mr. Merrels will talk to that further.

We respectfully then commend to the committee those bills that are now pending that achieve the goals of comprehensive deregulation of gas at the wellhead and at the burner tip, and we encourage you to grant the FERC the jurisdiction to compel that unused capacity be made available for transportation on a nondiscriminatory basis.

Thank you, Senator.

[The prepared statement of Mr. Gooch, counsel, Petrochemical Energy Group follows:]

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TESTIMONY
ON BEHALF OF THE
PETROCHEMICAL ENERGY GROUP

Committee on Energy and Natural Resources
United States Senate

May 20, 1986

Washington, D.C.

TESTIMONY OF THE
PETROCHEMICAL ENERGY GROUP
May 20, 1986

My name is Gordon Gooch. I am counsel to the Petrochemical Energy Group ("PEG"). PEG is an association of companies that rely on oil and natural gas as raw materials as well as for fuel use. PEG sincerely appreciates the opportunity to be heard.

PEG SUPPORTS THE TERMINATION OF PRICE AND OTHER CONTROLS AFFECTING WELLHEAD SALES OF GAS AND SUPPORTS FERC JURISDICTION OVER NON-DISCRIMINATORY TRANSPORTATION

The Petrochemical Energy Group respectfully urges the favorable consideration of legislation to remove the federal price and allocation controls over the wellhead sales of natural gas as part of a comprehensive reform of federal regulation that would (1) repeal the authority to constrain demand for gas and oil (2) repeal the authority to use discriminatory pricing as a tool to limit wellhead prices as well as a tool to direct gas costs to specific consumers and (3) grant to the Federal Energy Regulatory Commission the authority to do directly what it is attempting to do indirectly: require non-discriminatory transportation.

The cornerstone of any reform of the natural gas situation is the removal of federal price and allocation controls. The cushion of the lower cost, forever-regulated gas supplies is the root cause of the problems in the gas industry, whether in times of shortage or of surplus. Until the cushion problem is resolved, the Congress will be plagued with requests for special relief of one kind or another, as piecemeal adjustments are sought.

CURRENT SITUATION

According to the latest information available from the Energy Information Administration, based on projections gleaned from all PGA filings by the interstate pipelines, the composite situation appears to be:

	Average Price	Percent of Total Vol
"Old" NGPA Section 104 gas	$ 1.35	29%
Intrastate section 105 gas	1.98	1%
Rollover Contracts section 106	1.12	3%
New Gas (102, 103, 108, 109)	3.18	38%
High Cost Section 107	3.94	6%
Other Purchases than Wellhead	3.41	22%
Total Purchases	$ 2.67	

One who examines that information might well ask: how can it be that natural gas, a fungible commodity, has such a wide range of average prices? The answer comes back because of one major factor: federal price and allocation controls on wellhead sales.

Rather than confront the issue as a whole, there are some who prefer to isolate components in order to obtain an improvement over this status quo from their perspective, and this has yielded a gridlock.

GRIDLOCK ON THE SUBSIDIARY ISSUES OF WELLHEAD CONTROLS

The three major segments of the gas industry--the producer, the pipeline, and the distributor-appear to have achieved a gridlock. There appear to be four major issues, leaving aside, for the moment, the issue of contract carriage:

(1) federal restrictions on the sale of gas to a new purchaser when the wellhead contracts expire or are terminated, commonly called the ABANDONMENT and RIGHT OF FIRST REFUSAL problem;

(2) FEDERAL PRICE CONTROLS that can operate to restrain or operate as a price support for gas prices at the wellhead;

(3) contracts that call for the payment of the maximum lawful price established by the Congress or by the Commission under the NGPA or for a payment based on the agreement of the parties, commonly called by some the "NON-MARKET RESPONSIVE" contracts;

(4) whether the producer, the pipeline. or the distributor should pay the cost of holding gas supplies shut in the ground, commonly called the TAKE-OR-PAY problem.

Even when segregated and isolated in this manner, it is apparent that the issue is the same: price and access to supply. These are driven by the federal controls.

Abandonment jurisdiction means that the FERC must give its permission before deliveries of gas can be terminated, even under an expired contract. Thus, some forever-regulated gas supply cannot be sold to another purchaser without the prior consent of the FERC, only recently and sparingly given. This means that access to some 46% of total volume is severely constrained. On top of this, additional volumes cannot be sold to another purchaser without the first call being given to the former purchaser, a lesser restriction but a restriction nonetheless.

With federal price controls permanently in place, some gas is held well below the price that other purchasers would be quite willing to pay in order to secure a supply of gas. The parties cannot even agree to adjust the price to a higher market level; the federal government prohibits that without prior FERC approval.

When the so-called "non-market responsive" contracts are considered, it is necessary to place them in two subsets. Those that have been deregulated (and one party seeks relief from the contract in one form or another) and those sales that have not been deregulated where the ceiling prices established by the federal government are operating to maintain prices at levels where one party wishes relief.

It must be recognized that both subsets are no accident but are the result of the design of the NGPA. While some price ceilings were frozen at the level set in the 1970s by the Commission and adjusted only for inflation, subject to the continuing jurisdiction of the Commission to raise the price ceilings, incentive categories were also established by the Congress--but in two subsets.

One subset included those categories of gas that were designated for deregulation. The opportunity of parties to live by their contracts was deemed to be an incentive.

The other subset includes those categories of gas that were designated to receive a regulated incentive price.

Therefore, to attack those two subsets in isolation is to attack the design of the NGPA.

The result of this intentional design of the NGPA can perhaps be best observed by examining the EIA current data on Section 102 gas. That is the largest category of gas that is comprised of both deregulated and forever regulated incentive gas, comprising some 24% of EIA's projected total supply, almost the same volume as the old NGPA section 104 gas in relative volume. EIA informs us that, of the three sub-categories of section 102 gas, the following is the average price:

102 OCS New	$ 2.84	Deregulated
102 Onshore	3.15	Deregulated
102 OCS Old	3.77	Forever-Regulated

That is a thirty-four percent differential from the lowest average to the highest average price of the same category, with the average regulated priced above the average deregulated prices.

Next, as to take-or-pay, this too is related to price. Would anyone be concerned about take-or-pay payments on the sixty cent (60¢) section 104 gas?

PEG RESPECTFULLY SUGGESTS THAT TERMINATION OF THE FEDERAL CONTROLS WOULD LEAD TO A RATIONALIZATION OF THE SITUATION FAR BETTER THAN ANY OTHER ALTERNATIVE

This solution would be painful for some. The status quo is painful for some. The other suggested solution: reimposition of some form of federal controls on contracts would be painful on some.

But by allowing renegotiation with all four of the issues on the table offers the best hope of all the options. This requires termination of price and allocation controls.

What happens if federal regulation of the sale of gas at the wellhead is removed?

(1) The contracts between the parties will control according to the agreed upon terms.

(2) Where there are no contracts, gas may be sold to any potential purchaser without prior approval of the FERC or the prior purchaser.

Some will object to both results. Some will say that parties should not be permitted to live under private contracts. Some will even argue for the abrogation of contracts by the federal government. They will argue that the price of gas at the wellhead will increase substantially over the status quo case.

Others will argue that, with all contracts on the table and open to renegotiation, there will be an accommodation sufficient to improve the status quo situation. These, we believe, will not claim that all contracts will be renegotiated nor that there is a perfect correlation between those who have old gas and those who have the new and high cost gas, either by company or on an individual pipeline system, and this we understand.

What will the average price be upon decontrol? It could go up, it could remain the same, it could go down.

Some industrial users, such as PEG, are willing to assume the risk that wellhead prices will go up. We accept this risk, as consumers, because we believe that, in the long run, competition, both from gas and from other sources of energy, will induce a rational behavior by all segments of the gas industry--the producer, the pipeline, and the distributor.

And we believe that this rational behavior will be better induced by allowing the market to operate rather than by relying on federal regulation.

And how long would that process of rationalization take?

The answer to that lies in whether or not the Congress gives to the FERC the power to require that the available capacity on interstate pipelines be opened to all shippers and end users on a non-discriminatory basis. If the Congress does this, the process will be much shorter.

To an industrial user, open access means that the end user will have a legally enforceable option of dealing with (a) a local distribution company or (b) a pipeline or (c) a producer or any combination thereof. The user is perfectly willing to pay the fair cost of the use of transportation facilities owned by others.

If the end user is discriminated against in either cost or quality of service or on availability of service or if the end user is forced to be a captive customer, then the rationalization process will take much longer.

GAS SUPPLY

In times of apparent surplus, it is perhaps more difficult to express concern about supply. But supply is a real concern. We remember curtailments. We believe that the attempt by the federal government to administer prices and to allocate supply was the principal cause of curtailments.

If the Congress opts to reimpose controls, in whole or in part, then again the FERC has to decide what the "right" price or series of prices is in order to maintain an adequate supply for the present and the future. We would suggest, again, that a regression toward more controls will lead us back into curtailments. We would prefer to rely on the collective judgment of hundreds of producers, pipelines, distributors, and end users.

CONCLUSION

PEG thus respectfully commends to the Committee those bills now pending that achieve the goals of a comprehensive deregulation of natural gas at the wellhead and at the burner tip and that grant to the FERC the jurisdiction to compel that unused capacity be made available for transportation on a non-discriminatory basis.

Senator NICKLES. Thank you very much.

Our next panelist is Mr. Andy Merrels, director, energy purchases and hydrocarbon ventures, Owens-Corning.

STATEMENT OF A.S. MERRELS, DIRECTOR, ENERGY PURCHASES AND HYDROCARBON VENTURES, OWENS-CORNING FIBERGLAS CORP., ON BEHALF OF PROCESS GAS CONSUMERS

Mr. MERRELS. As you said, I am director of energy purchases and hydrocarbon ventures for Owens-Corning as well as chairman of the Process Gas Consumers Group.

The problem in today's gas market is notwithstanding the falling oil prices, pipelines continue to purchase and sell expensive gas priced higher than the free marketplace would permit.

Senator NICKLES. Mr. Merrels, would you pull the microphone down a little further.

Mr. MERRELS. Is that coming through?

Senator NICKLES. Yes.

Mr. MERRELS. This situation is made worse by the significant barriers which prevent producers from selling and end users from buying lower natural gas supplies. PGC believes that the interest of all the industry, producers, pipelines, distributors, and users, would be best served by making the purchase, sale, and transportation of natural gas as market oriented as possible.

Any legislative proposal must recognize and deal with the reality of today's gas market. Piecemeal tinkering with only one industry segment's perceived difficulties will only continue the problem or make it worse. Thus any meaningful legislation must contain strong provisions for open, nondiscriminatory transportation, both firm and interruptible.

Therefore PGC strongly supports S. 2285, the administration bill. We would support S. 1302, introduced by you, Senator Nickles, if appropriate language on open access transportation were added. We do not think that legislation limited to repeal of incremental pricing and the Fuel Use Act will have a meaningful impact on today's market problem. The single most important issue to PGC is the need for legislation providing open, nondiscriminatory transportation of natural gas.

Although order 436 is more than 7 months old, open and nondiscriminatory transportation remains generally unavailable for several reasons. First, order 436 is voluntary. Pipelines need not open their systems to nondsicriminatory transportation unless they elect to do so. Second, those pipelines that have considered opening their system pursuant to order 436 have proposed conditions that undermine the basic content of the order and are specifically discriminating against end-users who are granting preference to distributors.

Third, many parties continue to attack the validity of order 436 in any available forum. And finally, pipelines may obtain transportation authorization through individual certificates without subjecting themselves to the nondiscrimination and contract demand reduction conditions of order 436. The FERC has recently granted dozens of these, of such individual certificates on a blanket basis.

In short, intrastate pipelines and many distribution companies continue to thwart the operation of competitive forces by acting as bottlenecks to prevent or substantially limit meaningful gas price competition within their service areas. The only real solution to these problems is for the Congress to remove the barriers erected by the current pipeline practices to provide for open access transportation.

Finally, while PGC favors the repeal of the Fuel Use Act, a bill such as H.R. 4669, recently reported by the Fossil Fuels Subcommittee, limited to Fuel Use Act repeal, is not sufficient. The Fuel Use Act is having virtually no effect on industrial fuel selection because it contains a multitude of easily obtainable exemptions from the prohibition of boiler fuel use of natural gas.

What is really affecting industrial use of natural gas is the continuing refusal of pipelines and distribution companies to move low-priced natural gas owned by end-user shippers from producers to end-users. To merely repeal the Fuel Use Act and incremental pricing without dealing with those much more significant market barriers to natural gas competition will do nothing to increase our ability to use gas in the current market.

In conclusion, PGC strongly urges that Congress move now with comprehensive legislation that provides for open access transportation and thus really addresses today's gas market problems. Thank you.

[The prepared statement of Mr. Merrels follows:]

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BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

STATEMENT OF

THE PROCESS GAS CONSUMERS GROUP

May 20, 1986

COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

STATEMENT OF
THE PROCESS GAS CONSUMERS GROUP
May 20, 1986

I am A. S. Merrels, Director, Energy Purchases and Hydrocarbon Ventures, Owens-Corning Fiberglas Corporation, and Chairman of the Process Gas Consumers Group.

The Process Gas Consumers Group (PGC) is an organization of eighteen large industrial consumers of natural gas organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies with respect to gas use. Representing many of the nation's basic industries, our member companies own and operate hundreds of plants in virtually every state and purchase natural gas directly or indirectly from both interstate and intrastate pipelines, with most of our facilities on the interstate system. A list of our members is included as Attachment 1.

PGC appreciates this opportunity to offer its views on natural gas legislation pending before this Subcommittee.

I. PGC's Perspective

PGC members are energy intensive companies that individually spend as much as $200 million per year for their natural gas needs. Our members consume natural gas in manufacturing applications, including process, nonprocess, and boiler, and from our perspective, there are two paramount natural gas issues: (1) security of supply and (2) price.

Security of supply means to us the ability of consumers to depend upon their suppliers to satisfy their gas requirements. The current supply surpluses do not give us any significant comfort, because we remain skeptical that those resources will be efficiently produced, distributed, and replaced in a market that remains partially regulated under the Natural Gas Policy Act.

Natural gas prices, as with other inputs into the manufacturing process, present costs which must be recovered by companies in the prices charged for their products. We are willing to pay free market prices for gas, but we are strongly opposed to (1) paying prices higher than those which would be commanded in a truly free market and (2) paying a disproportionate share of gas costs so that other gas consumers can be subsidized, such as through so-called incremental or marginal cost-based pricing schemes. We believe that rates should be based on the cost of providing service. As consumers operating in competitive national and international markets, we and the Nation cannot tolerate the impact of artificially high gas prices on our businesses.

The gas market in recent years has been characterized by wildly disparate prices at the wellhead -- some far below "market clearing" and others substantially above it. Many pipelines have experienced industrial load losses caused by the purchase of expensive supplies under strict take-or-pay provisions which have, in effect, shut off cheaper supplies. High cost supplies were produced before lower-cost supplies, which further depressed demand and distorted the signals sent back to producers as to future gas needs, possibly setting the stage for potential future price premiums and shortages. Notwithstanding today's falling oil prices, pipelines continue to purchase expensive gas even though their own sales rates are higher than a free marketplace would permit. This situation is exacerbated by the significant barriers that remain to end user access to lower-priced supplies, barriers which also prevent producers from selling their lower-priced supplies into market and thus receiving much needed cash flow to encourage future drilling.

PGC's conclusion about what is needed to deal with these problems is that the interests of all involved in the natural gas industry -- producers, pipelines, distributors, end users, marketers, etc. -- will best be served by making the purchase, sale, and transportation of natural gas as market-oriented as possible. To accomplish this effectively, any legislative proposal must recognize and deal with the reality of today's gas market. Piecemeal tinkering with only one industry segment's perceived problems will merely continue or exacerbate the market distortions we have described. Thus, for example, any meaningful legislation must contain strong provisions for open access to nondiscriminatory transportation of both firm and interruptible gas supplies, because this will benefit end users, producers, pipelines and distributors by allowing market forces to eliminate bottlenecks in the system. In this spirit, PGC strongly supports legislation such as S.2285, the "Natural Gas Policy Act Amendments of 1986" recently proposed by the Administration. Similarly, we would support S. 1302, introduced by Senator Nickles, if appropriate language on open access transportation were added. We do not think that legislation such as S. 1251, which is limited to repeal of incremental pricing and the Fuel Use Act, will have any meaningful impact on market problems being faced today by all segments involved in the natural gas industry.

II. Specific Comments on Legislative Provisions

A. Open and Nondiscriminatory Access to Transportation

The single most important issue to PGC is the need for legislation providing for open, nondiscriminatory access to transportation of natural gas.

Order 436, issued on October 9, 1985 by the Federal Energy Regulatory Commission, represents the high-water mark for attempts to provide open, nondiscriminatory transportation in the natural gas industry. Yet, although Order 436 is more than seven months old, open and nondiscriminatory access to transportation remains generally unavailable. Indeed, the expiration of the previous blanket transportation certificate programs, combined with pipeline reluctance to truly accept Order 436, has frequently diminished the availability of transportation for prospective shippers. This delay on the Federal level is in turn delaying effective state action for open access at the local distribution company level. Thus, while PGC strongly supports Order 436, we believe that Congressional action should be taken to bring about open, nondiscriminatory transportation in the natural gas industry. Such action is especially warranted now as the transportation arrangements allowed by FERC under NGPA Section 311 as an alternative to Order 436 will be terminated on June 30 to avoid triggering distributors' contract reduction rights.

There are several reasons why Order 436 has not resulted in the immediate, widespread availability of nondiscriminatory transportation. First, Order 436 is voluntary; pipelines need not open their systems to nondiscriminatory transportation unless they choose to do so. Second, those pipelines that have considered opening their systems pursuant to Order 436 have often proposed conditions that undermine the basic content of that order and are blatantly discriminatory against end-user shippers as compared to distributors. Third, many parties continue to attack the validity of Order 436 in any available forum. Finally, pipelines may obtain transportation authorization through a Section 7(c) certificate of public convenience and necessity without subjecting themselves to the nondiscrimination and contract demand reduction and conversion conditions of Order 436; the FERC has recently granted approval of dozens of such transactions, even though proposed on a blanket, non-individual basis.

The first and most obvious reason that pipelines have not implemented the open access provisions of Order 436 is that FERC believes that it lacks authority under existing law to compel contract carriage of gas. Thus, a pipeline can exercise its monopoly power by refusing to open its system and in fact, many pipelines have done exactly that. PGC is troubled by this refusal by pipelines to accept open access pursuant to Order 436, particularly given current conditions in the energy markets. Although oil and gas wellhead prices have fallen, many pipelines' rates have not. Thus, many pipelines and their distributor customers face a very real threat of fuel-switching by some of their customers, while captive customers -- including many industrial process and feedstock users -- are forced to pay above-market prices for utilities' gas. Faced with falling gas demand, which will decline further this summer, many gas producers face shut-in supplies even if they are willing to sell gas at market prices. Yet, most pipelines are unwilling to truly accept Order 436 and allow competitive forces to facilitate a market equilibrium. Instead, pipelines and distributors have tended to adopt a stop-gap approach of attempting to hold their current market share and profits through devices such as selective price cutting even as they file general rate increases.

A second problem is that pipelines that have considered implementing Order 436 have proposed conditions which would undercut, and in some cases negate, its basic intent. Several pipelines are currently attempting to "negotiate" so-called "settlement" agreements in pending rate cases which include provisions purporting to implement Order 436. However, armed with the threat of not accepting the Order, several pipelines have attempted to demand settlement agreements that often contradict the goals and express terms of Order 436 including its key requirement of non-discrimination. In some FERC proceedings, for example, pipelines have agreed with their traditional wholesale customers -- including local distributors and fellow interstate pipelines -- to divide transportation rights in order to preserve their collective positions as monopolistic sellers through a variety of rate and service preferences which dramatically limit producers' and end users' ability to obtain fair, reliable transportation services. Thus, while the promulgation of the Order was an important first step, pipelines' monopoly power over transportation is frustrating achievement of truly open nondiscriminatory transportation. For example, while Order 436 mandates the allocation of capacity on a "first-come, first-served" basis, some pipelines and distributors have insisted on service preferences for their own sales and for distributor sales customers while producers and end users are left to accept the lowest quality interruptible service. To the extent that pipelines can insist on such conditions as the price for accepting Order 436, truly open, nondiscriminatory transportation will never occur.

Even where pipeline capacity is available to a potential shipper, other settlement provisions have been proposed that will serve to discourage transportation by some classes of shippers. For example, penalty and balancing provisions have been proposed by some pipelines, which would require $5-$10 per Mcf penalties for minor delivery imbalances under circumstances that are totally unrealistic in the gas industry. If allowed to stand, these would have the effect of favoring pipelines' own sales or brokerage affiliates or of preventing transportation by all but the largest and most sophisticated shippers. While some pipelines have softened these provisions somewhat, the proposed penalties typically bear no relation to any costs imposed on the system and tend to deter many shippers.

While FERC should be able to ferret out the discriminatory proposals, it may take months to do so. And even then, pipelines may continue to withhold transportation until they get the terms they want.

Adding to these uncertainties is a third problem -- the challenge to the legality of various aspects of Order 436 filed by numerous parties in the federal courts. For example, pipelines are arguing that, despite its voluntary nature, Order 436 is too close to mandatory carriage to be lawful under the Natural Gas Act or Natural Gas Policy Act. If Order 436, or some portion thereof, is overturned on appeal, nondiscriminatory transportation could again become an even more remote possibility.

Finally, the fourth problem with the implementation of Order 436 is that pipelines have another transportation alternative. A growing number of pipelines have recently received individual Section 7(c) certificates of convenience and necessity authorizing them to transport gas for specified shippers. Pipelines can, in that manner, transport gas without subjecting themselves to the Order 436 conditions such as nondiscrimination and CD reduction. Although FERC has said that users or producers who are discriminated against can file complaints, that is rarely a realistic option for users or producers. Since the burden of proof is on the shipper, even though the pipeline possesses the data on which the complaint must be based, a complaint proceeding at FERC can take one to three years, which is totally unrealistic in a fast changing energy market.

Given these four problems, if Congress is to deal effectively with the gas issue, it must address the fact that interstate pipelines and many distribution companies have tended to act as obstacles to the operation of competitive forces that would smooth out price and supply distortions resulting from the

NGPA. Because their facilities are essential to delivering gas to their customers, interstate pipelines and distribution companies have the power to act as bottlenecks to prevent or substantially limit meaningful gas price competition within their service areas. As the above-described problems illustrate, Order 436 is being thwarted by many pipelines, sometimes with the acquiescence of their distribution customers, and even over the objections of end users and producers. The only real solution to these problems is for the Congress to remove the barriers to entry erected by current pipeline practices and legislatively to provide for open access transportation.

B. Deregulation of Wellhead Price Controls

PGC continues to believe that deregulation of all natural gas at the wellhead, preferably by a time certain as called for in the Administration bill, is an important element of any natural gas legislation.

PGC is concerned that, while the conventional gas resource base may be sufficient to meet current levels of demand for some time, these resources will not be efficiently produced in the partially-regulated "market" under the NGPA. As previously noted, that market is characterized by disparate wellhead prices -- some far below competitive fuel costs and others substantially above them. Some pipelines are continuing to experience real industrial load losses as they purchase expensive supplies under strict take-or-pay provisions and turn away cheaper supplies. High-cost supplies are being produced on some pipelines before lower-cost supplies, and retail gas prices for system supply have remained at relatively high levels over the past year, despite a substantial supply surplus and falling oil prices.

The NGPA created a part-regulated, part-deregulated market in which the "cushions" afforded to some pipelines by the regulated portion of the market have allowed outrageously high prices to be paid for gas in the deregulated portion of the market. The uneven distribution of those cushions among interstate pipelines led many to fear that, upon partial deregulation on January 1, 1985, deep-cushion pipelines would have a decided advantage over shallow-cushion pipelines in obtaining new gas supplies by bidding up the price of deregulated gas, rolling it in with their cheaper supplies, and yet still remaining competitive at the burner tip. The fact is that, during the three to four years immediately following enactment of the NGPA, pipelines effectively neutralized the potentially distorting effects of their own respective cushions by purchasing deregulated Section 107 gas at super-inflated prices. By the time that partial deregulation occurred on January 1, 1985, the combination of first, many pipelines' unintended neutralization of their gas cushions through purchases of high-cost gas, and second, rapidly falling market prices for new gas supplies, resulted in many pipelines' already having weighted average gas costs above the current cost of new gas in the field. Rather than bidding prices up on January 1, 1985, pipelines invoked market-out clauses to try to bring prices down to market. Today, prices for new deregulated gas are, in some cases, below prices for some Section 104 "old" gas.

These anomalies can be best addressed by removing the price controls that have in many cases, become price "supports" for above-market priced gas. These price controls were at the root of most of the natural gas industry's problems over the past two decades, such as the curtailments of the 1970s, and they continue to create difficulties in today's market. PGC has long supported legislation to remove wellhead price controls on all gas, including "old" flowing gas, because of our firm view that a functioning competitive market is needed to balance supply and demand, without widely varying prices for a fungible commodity. Given the current low prices and the increase in sales that would be made possible by open access transportation, deregulation of currently regulated gas would not raise prices to consumers.

C. Repeal of Incremental Pricing and the Fuel Use Act

PGC also favors the repeal of incremental pricing and the Fuel Use Act but believes that such repeal should occur as part of a natural gas legislative proposal which also deals with today's real market problems, such as needed access to open, nondiscriminatory transportation.

The Fuel Use Act, contrary to the assertions of some, does not currently constitute a barrier to utilization of natural gas. As a major trade association of industrial users, many of whom are potentially affected by the FUA's prohibition on industrial use of gas or oil, PGC disagrees most strongly that repeal of FUA will do anything to assist our current inability to obtain gas for our plants. Apparently, many in Congress and elsewhere believe that a bill, such as S. 1125, only repealing the FUA and incremental pricing, would constitute a solution to the current problems of the natural gas market. For example, an American Gas Association study of August 31, 1984, entitled "Projected Economic and Environmental Impacts of Retaining the Fuel Use Act Through the Year 2000," tries to make the case for legislation limited to FUA repeal by claiming that 1.9 quadrillion Btu's of gas would be available to industrial users annually if only FUA were repealed. On page 7, this study makes the rather extraordinary underlying assumption:

> ". . . it was assumed that the FUA exemption process is effectively inoperative. . . . it was assumed that the exemption process would not work as a result of either stringent regulatory enforcement policy, or the fear of plant operators of becoming involved in costly and time-consuming exemption procedures with the ultimate outcome unknown."

For the following reasons, this assumption is patently incorrect and makes the study worthless as any indicator of the real world of industrial gas use. The Fuel Use Act contains a multitude of exemptions from the prohibition on boiler use of natural gas, and under the Reagan Administration's 1981 revision of the Fuel Use Act rules, 46 Fed. Reg. 59872 (December 7, 1981), these exemptions are very easy to obtain. As shown in the attached materials from DOE annual reports on FUA, between January 1, 1983, and December 31, 1985, 86 exemptions were granted by DOE to utilities and Major Fuel Burning Installations (industrial plants) out of the 118 that were received and the remainder were being processed. No completed applications were turned down. The Fuel Use Act is having virtually no effect, contrary to assertions such as those of AGA, on industrial fuel selection.

What is really affecting on industrial use of natural gas is the continuing refusal of the pipelines and distribution companies to move low-priced natural gas owned by end user shippers from producers to end users, accompanied by the market distortions of wellhead price controls. In addition, the alleged impact of the Fuel Use Act is on new facilities and it is existing facilities that could provide the market for gas today, not new plants that may be constructed some time in the future.

PGC does not disagree that the Fuel Use Act should be repealed because of the potential that it could be used by some future Administration to influence industrial fuel use choices as it did before the reforms of 1981. Similarly, incremental pricing can have the effect of distorting price signals, not only as to the current resource cost of gas, but even as to a pipeline's average cost of gas. This is because incremental pricing generally requires that non-exempt industrial boiler fuel users pay a gas price no less than the EIA-determined price of No. 6 oil; this requirement could in certain market circumstances deprive industrial users of the benefits of such producer-pipeline gas price renegotiation as does occur.

But merely to repeal the Fuel Use Act and incremental pricing as S. 1251 would, without dealing with more significant market barriers to natural gas access, do nothing to increase our ability to use gas in the current market.

III. Conclusion

In conclusion, PGC strongly supports enactment of legislation which recognizes and deals with the reality of the problems of today's gas markets. Legislation such as the Administration's bill accomplishes this particularly because of its provision for nondiscriminatory transportation of natural gas. Piecemeal approaches, which deal with limited or non-existent problems, will not provide the type of relief that is needed.

We appreciate the opportunity to appear before this Subcommittee on this most important topic and will be pleased to answer any questions you may have.

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General Motors Corporation

Hershey Foods Corporation

LTV Steel Company

National Can Corporation

Owens-Corning Fiberglas Corporation

Owens-Illinois, Inc.

ATTACHMENT 1

ATTACHMENT 2

POWERPLANT
AND
INDUSTRIAL
FUEL USE ACT

ANNUAL REPORT

Submitted Pursuant to
P.L. 95-620, Section 806

March 1, 1985

U. S. DEPARTMENT OF ENERGY
Economic Regulatory Administration
Office of Fuels Programs
Washington, D. C. 20585

EXHIBIT 1

Sheet 1 of 2

STATUS OF EXEMPTION PETITIONS
RECEIVED THROUGH DECEMBER 31, 1984
FOR NEW POWERPLANTS

Company	Facility Location	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
U.S. Borax*	Boron, CA	1*	Granted Cogeneration	49 FR 7854 (3-2-84)
Calcogen, Inc.	Norwalk, CA	1	Granted Cogeneration	49 FR 21560 (5-22-84)
Bayou Cogeneration Plant	Pasadena, TX	1	Granted Cogeneration	49 FR 25513 (6-21-84)
Greenleaf Power Corporation	Sutter County, CA	1	Granted Cogeneration	49 FR 25513 (6-21-84)
Sacramento Municipal Utility District	Sacramento, CA	1	Granted Peakload	49 FR 31481 (8-7-84)
Anchorage Municipal Light & Power	Anchorage, AK	2	Granted Reliability of Service	49 FR 34397 (8-30-84)
Power Systems Engineering	Harris County, TX	1	Granted Cogeneration	49 FR 44945 (11-13-84)
Cogen Lynchburg, Inc.	LaPorte, TX	1	Granted Cogeneration	49 FR 47096 (11-30-84)
Turlock Irrigation District	Stanislaus County, CA	2	Granted Peakload	49 FR 49167 (12-18-84)
Northern California Power	Lodi, CA	1	Granted Peakload	49 FR 49707 (12-21-84)

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*Received during 1983.

EXHIBIT 1 (Continued) Sheet 2 of 2

STATUS OF EXEMPTION PETITIONS RECEIVED THROUGH DECEMBER 31, 1984 FOR NEW POWERPLANTS

Company	Facility Location	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
AES Geismar	Geismar, LA	1	In Process Cogeneration	---
AES Placerita	Newhall, CA	2	In Process Cogeneration	---
Alaska Electric Generation & Transmission	Soldotna, AK	1	In Process Reliability of Service	---
Calcogen, Inc.	San Luis Obispo, CA	1	In Process Cogeneration	---
Northern California Power	Alameda, CA	2	In Process Peakload	---
Northern California Power	Placer County, CA	2	In Process Peakload	---
Northern California Power	Ukiah, CA	2	In Process Peakload	---
Operating Leasing Services, Inc.	Chino, CA	1	In Process Cogeneration	---
Sunlaw Energy Corporation	Vernon, CA	1	In Process Cogeneration	---
Texasgulf, Inc.	Newgulf, TX	1	In Process Cogeneration	---
	Total Petitions (Including 1 submitted in 1983)	26		

EXHIBIT 2

Sheet 1 of 1

STATUS OF EXEMPTION PETITIONS RECEIVED THROUGH DECEMBER 31, 1984 FOR NEW MFBIs

Company	Facility Loation	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
University of Michigan	Ann Arbor, MI	2	Granted Cogeneration	49 FR 19698 (5-9-84)
Owens-Illinois	Orange, TX	1	Granted Emergency Purposes	49 FR 35222 (9-6-84)
General Motors Corporation	Shreveport, LA	1	In Process Lack of an alternate fuel supply at a cost which does not substantially exceed the cost of using imported petroleum	---
~~New~~ England Ethanol Products	Auburn, ME	1	In Process Emergency Purposes	---
Willamette Industries	Hawesville, KY	1	In Process Emergency Purposes	---
	Total Petitions	6		

ATTACHMENT 3

POWERPLANT
AND
INDUSTRIAL
FUEL USE ACT

ANNUAL REPORT

Submitted Pursuant to
P.L. 95-620, Section 806

March 1, 1986

U. S. DEPARTMENT OF ENERGY
Economic Regulatory Administration
Office of Fuels Programs
Washington, D. C. 20585

EXHIBIT 1

STATUS OF EXEMPTION PETITIONS RECEIVED JANUARY 1 - DECEMBER 31, 1985 FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION----		
ARCO Petroleum, Watson, CA	1	In Process
American Cogen, Spreckels, CA	2	In Process
Basic American Foods, King City, CA	1	Granted, 51FR4798, 2/7/85
Carson Energy, Inc., Carson, CA	1	Granted, 50FR50196, 12/9/8
CoGen Kern Bluff, Inc., Kern, CA	1	In Process
Cogeneration & Tech. Dev., Atlas, CO	3	Granted, 50FR25754, 6/21/8
Crown Zellerbach Corp. St. Francisville, CA	1	In Process
Dartmouth College, Hanover, NH	1	In Process
General Electric, Lynn, MA	1	In Process
General Electric, Co., Texas City, TX	1	Granted, 50FR31904, 8/7/8
General Electric, Cogebay, TX	3	Granted, 51FR3400, 1/27/86
Gilroy Energy Co., Gilroy, CA	1	Granted, 50FR25119, 6/17/8
Harrisburg Energy Co., Harrisburg, PA	1	Did not need FUA exemption
Klondike Equity, Klondike V, CA	1	In Process
Klondike Equity, Klondike I, CA	1	Granted, 51FR4420, 2/4/86
Klondike Equity, Klondike II, CA	1	Granted, 51FR4419, 2/4/86
Klondike Equity, Klondike III, CA	1	In Process
Merck Co., Kelco, San Diego, CA	1	In Process
Northern Cogen One, Texas City, TX	1	In Process
OLS Berkley, San Francisco, CA	1	Granted, 50FR29738, 7/22/8
Simpson Paper Co., Pomona, CA	1	Granted, 50FR37401, 9/13/8
Smith Cogeneration, Firestone, OK	1	Granted, 51FR674, 1/7/86

EXHIBIT 1 (Continued)

STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985
FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION (Cont'd)----		
Sunlaw Energy Corp., Park I, CA	1	Granted, 50FR50197, 12/9/85
Sycamore Cogeneration, Sycamore, CA	4	In Process
Temple-Eastex, Diboll, TX	2	In Process
United Cogen Inc., Los Angeles, CA	1	Granted, 50FR33825, 9/21/85
Univ. of Alaska, Fairbanks, AK	1	In Process
University Cogeneration, Kern, CA	1	Granted, 51FR675, 1/7/86
Willamette Ind., Port Hueneme, CA	1	In Process
** Total Cogenerators	38	
----PEAKLOAD----		
Oklahoma Gas & Electric		
Horseshoe Lake, OK	4	Granted, 51FR4792, 2/7/86
Muskogee, OK	4	Granted, 51FR4791, 2/7/86
Mustang, OK	4	Granted, 51FR4794, 2/7/86
Seminole, OK	4	Granted, 51FR4793, 2/7/86
Sooner, OK	3	Granted, 51FR4952, 2/10/86
Santa Clara, City of, CA	1	Granted, 50FR41554, 10/11/8
Texas Utilities Generating		
DeCordova, TX	4	Granted, 50FR26033, 6/24/85
Permian Basin, TX	5	Granted, 50FR26035, 6/24/85
Morgan Creek, TX	6	Granted, 50FR26034, 6/24/85
Boston Edison, Walpole, MA	1	Granted, 51FR5758, 2/19/86
** Total Peakload	36	

EXHIBIT 1 (Continued)

STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985
FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----SITE LIMITATION----		
Thermo Power & Electric University of N. Colorado, CO	2	Granted, 51FR2543, 1/17/86
** Total Site Limitation	2	
----COST----		
Consolidated Power, West Rutland, VT	1	In Process
** Total Cost	1	
----RELIABILITY OF SERVICE----		
Alaska Electric		
Hollywood, AK	2	In Process
Soldotna, AK	1	In Process
Anchorage Mun. Lgt. & Power		
George M. Sullivan #11, AK	1	In Process
George M. Sullivan #12, AK	1	In Process
Chugach Electric Assoc.		
Beluga #9, AK	1	In Process
Beluga #10/11, AK	1	In Process
Beluga #13/14, AK	1	In Process
Beluga #16, AK	1	In Process
International Station #4, AK	1	In Process
Soldotna #3, AK	1	In Process
Golden Valley Inc.		
Hollywood, G.V., AK	1	In Process
** Total Reliability	12	
TOTAL POWERPLANT EXEMPTION REQUESTS	89	

EXHIBIT 1A

STATUS OF EXEMPTION PETITIONS RECEIVED DURING 1984, ACTIVE ON JANUARY 1, 1985 FOR NEW POWERPLANTS AND MFBI's

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION----		
AES Placerita, Inc. Newhall, CA	1	Granted, 50FR13273, 4/3/85
Applied Energy Services, Geismar, LA	1	Granted, 50FR16538, 4/26/85
OLS Energy, Chino, CA	1	Granted, 50FR47254, 11/15/8
Texasgulf, Inc., Newgulf, TX	1	Granted, 50FR8184, 2/28/85
** Total Cogenerators	4	
----PEAKLOAD----		
Northern California Power		
Alemeda Peaking Facility, CA	2	Granted, 50FR5296, 2/7/85
Placer County Peaking Facility	2	Granted, 50FR5297, 2/7/85
Ukiah, CA	2	Granted, 50FR14281, 4/11/8
** Total Peakload	6	
----RELIABILITY----		
Alaska Electric, Soldotna, AK	1	Granted, 50FR14413, 4/12/8
** Total Reliability	1	

INDUSTRIAL EXEMPTIONS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----EMERGENCY PURPOSES----		
New England Ethanol, Portland, ME	1	Granted, 50FR6379, 2/15/85
Willamette Industries, Hawesville, KY	1	Granted, 49FR10095, 3/13/8
** Total Emergency	2	
----COST----		
General Motors, Shreveport, LA	1	Granted, 50FR13411, 4/4/85
** Total Cost	1	

EXHIBIT 2
STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985
FOR NEW MFBI's

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COST----		
Huntsville, City of, AL	4	In Process
LTV Steel Co., Aliquippa, PA	1	Granted, 51FR3824, 1/30/86
Owens-Illinois, Orange, TX	1	In Process
Ponderay Newsprint, Usk, WA	1	In Process
** Total Cost	7	
----EMERGENCY PURPOSES----		
Boise Cascade, DeRidder, CA	2	Granted, 51FR4789, 2/7/86
** Total Emergency	2	
----MIXTURES----		
Occidental Chemical, Lake Charles, LA	2	In Process
Power Developers, Inc. Alta, AR	1	In Process
** Total Mixtures	3	
----SITE LIMITATION----		
General Electric, Fitchburg, MA	1	Granted, 51FR3647, 1/29/86
Penwalt Corp., Wyandotte, MI	2	In Process
** Total Site	3	
TOTAL MFBI EXEMPTION PETITION RECEIVED	15	

Senator **Nickles**. Mr. Merrels, thank you very much for your statement.

Senator Domenici, we welcome you to the committee. Do you have comments, questions?

Senator **Domenici**. No, I do not. I just want to compliment you for your leadership in this role and for the hearing. I think it is imperative that we move. Whatever it is that we can get out of the committee, I think it is an opportune time, everything from Fuel Use Act repeal to the other proposals involving transportation and the like. My concern is that if we try to do too much we will not do anything. But other than that, I have no substantive comments at this point. I will have some questions later.

I would ask, did you ask the Secretary—I could not be here when he testified—whether or not he has any idea as to the House's intention of moving with part or all of what he has recommended?

Senator **Nickles**. I can answer that. The House will move on the Fuel Use Act alone. They are not going to do anything else.

Senator **Domenici**. That is my understanding. I talked to the Secretary last week, and he thought to the contrary. I wonder if he was asked here today.

Senator **Nickles**. That question was not asked, and maybe I am giving an editorial comment, but I do not think the House is going to do much besides the Fuel Use Act. At least that is my understanding.

Senator **Domenici**. Thank you very much, Mr. Chairman.

Senator **Nickles**. However, I would add that that should not prohibit us from taking a more comprehensive approach, and we will resolve the differences in conference. I will again compliment Senator Domenici, because he has been one of the pushers for doing something on natural gas, and I will share that statement. I want to do as much as we can that would be in a positive way to help the natural gas industry.

I will just start out and ask you a couple of questions. Mr. Bush and Mr. O'Neill, I heard big differences concerning the amount of take-or-pay liability exposure for the amount of renegotiations that have taken place. I think, Mr. O'Neill, you gave me a statement that presently, what, 9.4 billion and estimated to go up to maybe 12 to 16 billion by the end of the year, as far as take-or-pay liability that is still hanging out there? Is that for all of the pipelines, I guess?

Mr. **O'Neill**. The 9.4 billion was based on an estimate of 80 percent of the interstate market.

Senator **Nickles**. Is that just the INGA members?

Mr. **O'Neill**. Yes, I think that would be, I assume, INGA members. There may be some others that were not, but I think this is basically INGA.

Senator **Nickles**. Mr. Lawrence, does that sound accurate to you, or do you have different figures?

Mr. **Lawrence**. We have not specifically quantified that. We have got 6.2 billion at the end of 1985 and growing.

Senator **Nickles**. 6.2 in 1985?

Mr. **Lawrence**. I think the 6.2 is consistent with INGA at the time they made their estimate at the end of 1985.

Senator NICKLES. Mr. Bush, do you want to give your estimate, or does that sound accurate to you?

Mr. BUSH. We have the same problem trying to figure out which is the right estimate between the 6.4 and the 9.2. Let me tell you what I think has happened and I think is true. We have done a survey of 15 producers in order to file before the Federal Energy Regulatory Commission a response to their position about take-or-pay. And we asked them what their take-or-pay liabilities were from 1981 to 1985 and what was the resolution or the nonresolution of those numbers, and then what was the ongoing state of renegotiations.

In that result we found that they had $8.2 billion in accumulated liability from 1981 to 1985 of which about 5.6 plus was resolved, renegotiated, the liabilities were renegotiated, and 2.5 were still outstanding. Of the 2.5, about two-thirds of that was of recent vintage, 1985, or very, very late in 1984. We found interestingly, too—so that means that settlements were outpacing liabilities about 2 to 1 among producers that we surveyed, the 15 producers we surveyed. Interestingly, we found that one of the biggest problems with the exposure in the liability nonrenegotiation in 1985 in particular was in the MMS. In the Interior Department, they were asking for above market, if you would, recovery on take-or-pay payments, and some of those contracts were difficult in renegotiating some of them.

The fact is that what you hear about, when you hear projections of $12 to $16 billion, gee whiz, scenarios of potential exposures, those exposures are projections based on worst-case scenarios and assumptions, but the facts show that we are settling and renegotiating. We have stated often it is not in the interest of a producer to drive the only vehicle for moving gas to the market into bankrupcty. It is simply beyond common sense for a producer to want to seek financial ruin of the pipeline industry. We are trying to renegotiate these problems. What we are seeking is allocation of some of the dollars to it.

Senator NICKLES. When you have a settlement between a pipeline and producer, there is a certain take-or-pay obligation. Is it usually reduced or settled on a small percentage, 50 cents on the dollar?

Mr. BUSH. We surveyed 12 interstate pipelines and the publicly available data in the same years, 1981 to 1985, for the numbers that were available. We found that there were about $4 billion—$3 billion, $3.7 billion of liabilities that were publicly available. You have to understand that in many cases publicly available data is not there because there are confidential agreements often that prohibit the disclosure of the renegotiated amount, but where there was publicly available data, we found that there was $3.7 billion in liabilities from 1981 to 1985 that were settled for a total of about $450 million or on average about 12 cents on the dollar. That is the extent of the renegotiated obligation that was borne by those pipelines we were able to see.

Now, I am not saying that every pipeline settled for 12 cents. Some settle for 20 if they get to stay on the system. Some settle for eight. So you have the wide variation between a panhandle settlement and a Columbia settlement. You have the variation within the pipeline. But it is by far minimal compared to the dollar for dollar.

Senator **Nickles**. Mr. O'Neill or Mr. Bailey, tell me what this means to your pipeline. What does this mean to TRANSCO? What does it mean to Northwest Central?

Mr. **O'Neill**. Do you mean where are we with regard to renegotiation, Senator?

Senator **Nickles**. Yes, and how does that affect your pipeline? Are you looking at take or pay?

Mr. **O'Neill**. Maybe I could tell you about TRANSCO for a second. Essentially we have filed a proposed settlement with the FERC by the terms of which, if approved, we would go open access. What we are doing at the same time is attempting to renegotiate our gas purchase contracts with our producers. We are not counting on any relief from anyone, and we are out actively trying to renegotiate those contracts. I will tell you that a majority of the producers involved, I think, have been very willing to sit down and discuss the renegotiation of the contracts. It is going to be very expensive, and we recognize that.

One of the big problems I will at the same time tell you is that the exposure is enormous. It does not take a large percentage of producers to hold back and cause a very serious problem in terms of getting this problem resolved, so that is one of the big problems we face as we consistently have seen our ability to negotiate with producers cut out from under us in terms of order 380 and then provisions of 436 that would permit unilateral reduction of the contracts we have with our customers, and that is a big problem with us.

Now, take a look at the possibility and probability of losing our ability to negotiate access to the system in exchange for take-or-pay relief. It becomes more and more difficult to deal with those who are very difficult to deal with in the first instance. The relief has been—it varies. Some people have given permanent relief in exchange for the consideration that we have offered. Others are not willing to do that. They want to keep you sort of on a treadmill on an ongoing basis. That is pretty much where we are.

Senator **Nickles**. Are the settlements usually made for 20 cents on the dollar? Is there any rule of thumb that is close?

Mr. **O'Neill**. I would have to tell you that they vary considerably.

Senator **Nickles**. What kind of range? I am just wondering. I am seeking information.

Mr. **O'Neill**. I really do not know that I can divulge that information per se, because I do not have the actual dollars in front of me, but in general I would say that what we have been talking about in terms of take or pay, existing take-or-pay relief is somewhere in the 15-cent range. Let us just say that in general that is what we think would be reasonable. That is not necessarily what the producer thinks is reasonable.

We also have the problem with permanent relief of talking about future possibile liabilities, the value of those reserves. That is not reflected necessarily in Mr. Bush's numbers. In our system we estimated some time ago that we could potentially incur about 6 billion dollars' worth of this kind of liability. I am not saying we are going to, because we will take every step we can to try to renegotiate, but that is the kind of number we are dealing with in trying to get relief, and it is not easy when, as I say, we keep losing every opportunity to encourage that.

Senator NICKLES. As the prices are declining, you have some of those contracts where maybe you had a one or two contract or something out. Since the market price for spot gas is declining, do you see the take-or-pay exposure on some of those existing contracts increasing even day by day?

Mr. O'NEILL. Yes, that is obviously happening. The market is going to set the price. That is purely what is going to happen. The truth of the matter is, we have surplus, and with prices being where they are, prices for natural gas in the marketplace are very depressed. That does not change necessarily the contract situation. We may be taking gas and only telling a producer that we are able to pay such and such as price for it, because that is all we can move it for. That does not change the potential liability associated with the sale, so although we may be in a PGA paying a reduced price, that does not mean the exposure is not there from a contract standpoint.

Senator NICKLES. But if you had declining prices and you had some take-or-pay exposure, and you are working on settling those, and let us say a significant percentage are settled, since the prices are declining, are you able to incorporate that into and have your customers pay for that, your LDC's or whoever?

Mr. O'NEILL. Pay for what?

Senator NICKLES. Pay for that—incorporate or include the settlement on your take or pays and——

Mr. O'NEILL. In rates, you mean?

Senator NICKLES. Yes.

Mr. O'NEILL. That is a very iffy question at the current moment as to what the potential exposure of distribution companies are with respect to the cost of take-or-pay settlement.

Senator NICKLES. Correct me if I am wrong, but was not that take-or-pay liability incurred so you could guarantee delivering gas to your customer?

Mr. O'NEILL. Absolutely. Absolutely, and we obviously secured these gas supplies for our customers, and that was the sole purpose. We do not make a penny on the purchase and sale of gas. And as we are finding out here, we can lose very substantial amounts of money in that regard.

Senator NICKLES. Mr. Bailey, let me ask you somewhat the same question. Northwest Central, are you looking at how serious a problem with take-or-pay exposure?

Mr. BAILEY. To date we are fortunate that our gas supply profile has allowed us to largely avoid take or pay of the order of magnitude that a number of the other companies have experienced. I might make a general comment. It seems to me that there may not be—that the disparity in numbers that people sense because NGSA has focused on the amount of take or pay resolved. AGA and INGA have focused on the amount unresolved, and I suspect the numbers, if you were to accumulate the numbers in total, that they are not inconsistent.

Senator NICKLES. Let me ask you another question. You mentioned in your statement, and I am interested in hearing from Mr. Lawrence or other experts in the field, but you mentioned a concern, as othe pipelines have concerning the carriage provision, you mentioned the standard without discrimination, you mentioned possibly modifying that to without undue discrimination. Is that——

Mr. BAILEY. That is correct.

Senator NICKLES. Would that make it acceptable to you if we had a transportation access carriage provision, if we said pipelines will carry unless—without undue discrimination?

Mr. BAILEY. That is an essential element of any transportation provision, and I was frankly pleased to hear Secretary Herrington today embrace the kinds of things that I think that type of a standard would allow pipelines and the Commission to style in various tariff offerings. Our concern is that if a different standard is put forward, that the courts will impute a more narrow meaning to it than the well known meaning that has associated an undue discrimination standard in a variety of arenas.

Senator NICKLES. You think without discrimination would put much more of a burden on the pipeline to be moving that gas regardless whereas without undue discrimination would provide, what, pipelines more flexibility in refusing to carry unless certain hoops were jumped through?

Mr. BAILEY. I think the without discrimination is narrow enough just on its face that it would stimulate a number of court challenges, and the challenge would basically be predicated on the fact that Congress intended a more restrictive intent because it clearly departed from language that it had used in a variety of other legislation, and that as a result, the agency, I feel, would more narrowly interpret it, and that the kinds of things that you really hope to accomplish, which is increase the overall level of transportation, create a free or an open transportation network which allows distribution if gas supplies around the country just would not happen to the degree that you would hope it would.

Senator NICKLES. Mr. Lawrence, do you have a comment on that?

Mr. LAWRENCE. Yes. The DC Court of Appeals came up with the 436 proceeding, but it related to the customer end, the distributor end. If this Congress starts laying down a nondiscriminatory or discriminatory standard, then I think you are going to have discrimination in somebody's eyes on any kind of a negotiated carriage arrangement. We have already begun to hear it here. We have situations where pipelines are working out negotiated carriage arrangements now with their distributors, much of it pursuant to contracts which people do not want to abrogate, and yet they are contending that this is some sort of discrimination. Our concern with the statutory carriage is, if this Congress mandates that, if Mr. Porter's constituents and Mr. Bouche's constituents have this right to make a deal, and they are going to mandate that it be hauled, then we have polarized all the arguments, and you are going to have it every step of the way as to carriage, and I think the negotiated carriage arrangements that are generally beginnining to work will be out the widow, and we are going to have a lot more of this gridlock, I am afraid, than Mr. Porter mentioned.

Senator **Nickles**. Mr. Bailey.

Mr. **Bailey**. I would like to respond as well to one of the things that has been said, and that is the suggestion that the negotiated settlements that are moving forward with a number of pipelines, our own included, are taking place in some kind of closed door meeting. I assure you that there is active participation on the part of all of the various groups represented in this panel as well as State agencies and the Federal Energy Regulatory Commission, and that ultimately any negotiated settlement in order to be moved through the Commission must be sufficiently acceptable to all of the parties involved to be certified to the Commission for its final review and approval as an uncontested settlement, and I would suggest that that process is in fact working, and that all of the interests are being heard and are being accommodated, and yet there are unique differences as between individual pipelines and individual players in the equation that require that differences result in the end result in each of the various systems.

Senator **Nickles**. So is it your contention comparable to Mr. Lawrence's, that Congress should not do anything on transportation, just leave it up to FERC and 436, and hopefully we would end up getting more carriage?

Mr. **Bailey**. I guess my reaction is that with 436 in place, that in a sense the genie is out of the bottle, and it is not going to go back in, and admittedly there is litigation associated with it, but if you look at what is actually happening, a substantial number of pipelines are already moving forward in the negotiation process. I share Mr. Lawrence's view that the jury is still out. It is too early to really draw a final conclusion, but my judgment is that you will see the end of that process result in a very comprehensive transportation network that is styled to meet the unique needs of all of the various interests in each of the pipelines and market areas.

Senator **Nickles**. You used to work with an oil pipeline which did work strictly on a carriage provision. Are the gas pipelines—I will ask this to Mr. Lawrence, Mr. Bailey, and Mr. O'Neill. Are the gas pipelines, regardless of what we do under this legislation or 436, is the market such that we are going to be moving more and more into carriage, or will it strictly be because of 436, or just because of this legislation?

Mr. **Lawrence**. I will start. We are seeing a great proliferation of distribution companies with the encouragement of State regulations for carriage arrangements, more flexible to meet the competition in the marketplace. And our concern—75 percent of the AGA membership is distributors, not pipelines. Our concern just is not with 436 or how that might get buggered up, but I have heard you say, Senator, that what started out to be a 2-page mandatory carriage bill ended up 60, and there was a great deal of preemption of State regulatory process in that regard, and many of these States feel like they are stepping up to this in their own way, in ways that genuinely is encouraging distributor contract carriage arrangements. And that is good, and it needs to be permitted to work. It does not need to be stopped in its tracks by Federal statute.

Mr. **Bailey**. The current market conditions are certainly stimulative of additional carriage, because you have a surplus of gas, and you provide end-users the opportunity to compete against the pipelines' WACOG's. I think the market pressures for transportation diminish as supplies tighten. So in one sense I think the current market certainly creates economic incentives for transportation, and on the other hand over time you are going to see that pressure ebb and flow with the supply-demand situation.

Senator **Nickles**. Mr. Merrels, Mr. Porter, how is it working?

Mr. **Merrels**. As I implied or said earlier in my statement, we do not feel that there has been that much progress made, and we have several concerns regarding the lack of progress. First of all, the only allowable mechanism that is in force today to transport gas is section 311, and that is temporary, because that expires at the end of June. I fully recognize that there are settlements moving ahead, and I would agree with Mr. Bailey, he has got all parties involved in his settlement, but I think there are a couple of other points that need to be looked at.

After you get 436 settled as an end-user downstream you still have potentially 48 more problems, being the State level, and I strongly disagree with Mr. Lawrence. We have not seen anything but a ruse in the State of California on contract carriage from the standpoint of pricing, and in the State of Ohio we have just seen an order come out that hopefully will go back for rehearing, which would devastate transportation and self-help gas to the State of Ohio, so I think the point that the end-users are trying to bring forth is that we would like to see Congress move ahead to mandate FERC's authority to move ahead on this. The time is running out, and frankly even some of the supplies that were grandfathered under the past blanket certificate rulings for process gas users, those, because they are so limited, those supplies, normal decline curves are coming down, so we are losing what we have, and we are not getting the direction we would like to see ourselves going.

Senator **Nickles**. Mr. Merrels, thank you very much.

Senator Domenici, I apologize for taking so long in the round of questioning. Do you have any questions?

Senator **Domenici**. I have no questions.

Senator **Nickles**. Excuse me. I thought you were waiting to ask some questions.

Dr. Cooper, one final question to you. You mentioned your objections or opposition to the administration's past bill. I have got a bill. Are you opposed to that bill as well?

Dr. **Cooper**. Let me say we have been given a little score card here. We support contract carriage, which half of the panel does. We are not even very much opposed to intelligent changes in the Fuel Use Act, as most of the panel does. We believe that—and this is farther than we have gone in the past—if you are going to abrogate the obligation made on old gas, then you need to abrogate the obligations made in new gas, which brings us sort of we agree on contract abrogation with half the panel, we will be indifferent to old gas decontrol if we can get the other things right, which is, I think, more than we have been willing to say in the past about old gas decontrol.

Senator **Nickles**. Maybe I should stop there. If we are getting you to move, I think that is great progress. [General laughter.]

Thank you very much to our panelists.

Our next panel, the first panelist we have is Irene Wischer, Panhandle Producing Co., from San Antonio, on behalf of the Independent Petroleum Association of America.

Ms. Wischer.

STATEMENT OF IRENE WISCHER, CHAIRMAN, NATURAL GAS COMMITTEE, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Ms. WISCHER. All right. As you stated, I am Irene Wischer, chairman of the Natural Gas Committee of the Independent Petroleum Association of America, which represents 6,000 who produce natural gas and crude oil, and I am here also as president of a substantial pipeline company, but nonjurisdictional, and I am here to validate 32 years of confusion in the gas marketing arena. And before I get carried away, let me tell you how very pleased we are to have the opportunity to appear before you today to finally address the wide variety of enabling legislative proposals which have been introduced by many of you dealing with the use, sale, and transportation of natural gas.

As late as 1980, I was among those producers trying to explain to oil editors of the news media why we were having shortages in the seventies. Today I am trying to understand why the pipelines who provided me with take-or-pay contracts and incentives to drill more wells now are abrogating totally the sanctity of those contracts, and why I, as a producer, cannot do likewise. In fact, one of those pipelines has approached my company more than 30 times since August 1982, for some kind of change, lower takes, lower prices, pawning us off to a subsidiary company, and now saying take-or-pay requirements come under the umbrella of force majeure, and as we see company after company and individuals going broke, how many pipelines do you know about in chapter 11?

Our association just completed its midyear meeting on May 2, and at that meeting the following policy statement was adopted. I am going to read this.

> The U.S. natural gas producing and exploration industry finds itself in deep depression. A number of factors have contributed to this, including but not limited to falling world oil prices, depressed natural gas demand, surplus deliverability of wellhead supplies, lack of adequate transportation for shutin gas, and market distortions caused by remaining NGA and NGPA price and nonprice controls.
>
> To help independent producers more efficiently market their gas production at the most profitable levels, we recommended the following actions. Directly intervene in behalf of independents in pipeline rate cases pending before the FERC as a result of Order 436 transportation arrangements or other appropriate FERC matters to assure maximum producer access to pipeline transportation at affordable rates.
>
> Next, work with the Economic Regulatory Administration and FERC to assure that natural gas imports are not given favorable treatment over domestic production in either ultimate price or in transportation rates and services, and to intervene in import cases to achieve these goals.
>
> Next, continue to pursue a final legislative resolution of natural gas issues, including strong open transportation requirements, an end to remaining price and non-price controls, an end to all end use restrictions on natural gas, antitrust exemption for independent producer marketing cooperatives, and five, assurances that prices actually received are accepted as a basis for royalty payments to agencies managing Federal lands.
>
> To achieve these goals, we recommend that IPAA take necessary steps to direct association resources to new activities at staff and program levels. Specifically, we recommend the addition of staff counsel with FERC's expertise to execute and co-

ordinate independent producer intervention in transportation and import matters before appropriate Federal agencies.

That is the end of our policy.

[The prepared statement of Ms. Wischer follows:]

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Statement of the

Independent Petroleum Association of America

before the

Senate Committee on Energy and Natural Resources

On the Issue of Pending Natural Gas Legislation

May 20, 1986

I am Irene Wischer, Chairman of the Natural Gas Committee of the Independent Petroleum Association of America. I am speaking on behalf of the nearly 6,000 association members who produce crude oil and natural gas, operating in all of the domestic oil and gas provinces of the U.S., particularly onshore in the lower 48 states.

We are pleased to have the opportunity to appear before you today to address the wide variety of legislative proposals which have been introduced dealing with the use, sale, and transportation of natural gas.

Our association just completed it's Mid-Year meeting on May 2. At that meeting, the following policy statement was adopted:

"The U.S. natural gas producing and exploration industry finds itself in deep depression. A number of factors have contributed to this, including, but not limited to falling world oil prices, depressed natural gas demand, surplus deliverability of wellhead supplies, lack of adequate transportation for shut in gas and market distortions caused by remaining NGA and NGPA price and non-price controls.

"To help independent producers more efficiently market their gas production at the most profitable levels, we recommend the following actions be taken.

- Directly intervene in behalf of independents in pipeline rate cases pending before the FERC as a result of Order 436 transportation arrangements or other appropriate FERC matters to assure maximum producer access to pipeline transportation at affordable rates.

- Work with the Economic Regulatory Administration and FERC to assure that natural gas imports are not given favorable treatment over domestic production in either ultimate price or in transportation rates and services and to intervene in import cases to achieve these goals.

- Continue to pursue a final legislative resolution of natural gas issues including (1) strong open transportation requirements, (2) an end to remaining price and non-price controls, (3) an end to all end use restrictions on natural gas, (4) anti-trust exemption for independent producer marketing cooperatives, and, (5) assurances that prices actually received are accepted as a basis for royalty payments to agencies managing federal lands.

"To acheive these goals we recommend that IPAA take necessary steps to direct Association resources to new activities at staff and program levels. Specifically, we recommend the addition of staff counsel with FERC expertise to execute and coordinate independent producer intervention in transportation and import matters before appropriate Federal agencies."

Based on this, we beleive the natural gas problem focuses on three primary areas -- (1) transportation, (2) remaining Natural Gas Act dedication and price controls, and (3) end use restrictions. We beleive it is necessary and urgent for Congress to address all three areas and beleive it is possible to do so within a reasonable time frame if Congress has the will.

In addition, we urge the Committee to include language which would exempt small producer marketing cooperatives from anti-trust actions and which would make it clear once and for all that prices actually received by producers be acceptable to the Federal government for computing royalty payments due on federal lands.

Both these provisions were included by the Committee in it's development of S. 1715 in 1983 and we would simply ask that you readopt those provisions.

Having said this, we would like to be able to conclude our statement on that totally positive note of general support for proposals before you. However, there is another issue, that while not included in any of the proposals, looms as a threat to producers. That is the issue raised by the continued demands of pipelines and distributors for Congressional action to abrogate producer contracts in the name of take-or-pay relief.

Let us repeat today, what we told Senator Nickles' subcommittee last month.

Advocates of action to abrogate these contracts act as if they had nothing to do with writing or signing them -- that the government or some other party dictated the terms and pipelines and distributors were forced to sign them. This is not so.

These contracts were truly arm's length, two-party contracts when they were signed. No one held a "gun" to anyone's head.

Gas is no different than anything else. The difference between a good contract and a bad contract can be judged only against time. Hind sight always is 20-20.

If these were not sound contracts at the time they were entered into, then pipelines should be confronted by their stockholders and customers. But instead, it is being suggested again and again that action should be taken at the Federal level to force producers to take less than called for by the contract. Why should only one party to a contract which subsequently "turns sour" be expected to assume all of the costs associated with what we know now were not the best management decisions?

Let me give you a parallel example. At the time these "troublesome" contracts were signed, many producers were expanding their operations. It was not uncommon for a producer to borrow money at 18 percent to purchase a $3 million drilling rig. A lot of money? Yes. High interest rates? Yes. But the way things were going at the time, that deal could work with gas approaching $4 per Mcf and high take levels.

But today, with spot gas prices below $2 and interest rates 5-6 points lower, the rig deal was a bad deal. But is the bank eating it? Is the rig manufacturer expected to lower his price after the fact? Of course not, and producers are either sticking with the deal and paying for it out of other income or through disposition of other assets -- or through Chapter 11.

The same is true of the farmer who bought land at inflated prices a few years ago or the copper miner who opened a mine ten years ago when demand for copper was high. The developer in Oklahoma City who "built for the future" and the retailer in Peoria who expected Caterpiller and International Harvester to continue to grow are faced with handling "bad deals" today that looked like "good deals" a few short years ago. But they aren't calling upon the Federal Government to abrogate contracts they entered into in better times.

Lest we be misunderstood, gas producers are not insensititve to market conditions. Many have agreed to cut contract prices and grant pipelines take-or-pay relief only to see those pipelines and their distributor customers maintain such high margins that consumers still abandoned gas service. Producers don't beleive they should be expected to swap "take-or-pay" for "give and take" -- producers give and middlemen take. If pipelines and distributors are in such dire straits, why haven't we seen any bankrupcies in those sectors -- why should producers be the only ones faced with total loss?

Decontrol of old gas contracts is not "abrogation" as some would suggest. Those contracts were not honest two-party, arm's length efforts. The Federal government held the "gun" of price controls and acreage dedication to the heads of those entering those contracts regardless of supply-demand conditions. Now we ask that the government's "gun" be removed so that honest renegotiation can occur for the first time. It is within that renegotiation process, with all contracts on the table, that rational renegotiation can be acheived to the benefit of all parties.

Unless and until the current market distortion created by such a wide range of pricing is resolved, we don't believe any rational prices will evolve for the wells being drilled today and tommorrow.

Independents are the "wildcatters," the explorationists who drill most of those new wells. And at today's wellhead prices -- as low as $1 per Mcf in some cases -- few new wells will be drilled.

You know gas is worth more than $1. We know it is worth more than $1. Something is wrong and we urge you to get on with comprehensive gas legislation. If we don't do it now, we can assure you that in a few short years, everyone will be saying, "why wasn't something done?" as they did in the 1970's. History has a way of repeating itself and in this case, such a repeat could be disasterous.

Thank you.

Senator NICKLES. Ms. Wischer, thank you.

Ms. WISCHER. No, that is not the end of my statement. Do you want me to stop?

Senator NICKLES. I will come back to you in just a minute.

Mr. Gentry, would you care to be next?

Mr. GENTRY. Whatever is your pleasure, Mr. Chairman.

Senator NICKLES. If you would, I think that might help Senator Domenici as well.

STATEMENT OF R. CHARLES GENTRY, PARTNER, SHANK, IRWIN & CONANT, ON BEHALF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO

Mr. GENTRY. All right. My name is Charles Gentry, and I am representing the Independent Petroleum Association of New Mexico. Thank you, Mr. Chairman, for having these hearings. They come at a very critical time when the producing sector of the gas industry has many problems.

I have a longer statement which I ask be submitted for the record.

The Independent Petroleum Association of New Mexico recognizes that the congressional folklore indicates that natural gas legislation is such an emotional and politically difficult issue that two competing notions are superimposed over its consideration. First, it is a subject that legislators want to take up no more often than is absolutely necessary, preferrably no more often than once in a lifetime.

Senator DOMENICI. How do you know that? [General laughter.]

Mr. GENTRY. Second, natural gas legislation is even more tedious, frustrating, and time consuming if price decontrol is involved. As I mentioned previously, and as others have mentioned here and have documented, the producing sector of the natural gas industry is in deep trouble, and any help possible through legislative enactments is desperately needed, and the broader, the better. If the political atmosphere is such that the comprehensive legislation that would be the best cannot be enacted, the Congress must act now to provide that degree of relief that is possible to achieve.

The prospect that if a natural gas bill passes this year, which is very limited, such as any one of the nonprice components, most legislators will simply refuse to consider natural gas legislation next year. That notion, that prospect, we think, should be dealt with at that time. New Mexico independents feel that whatever that propensity is, its actuality should not be used as a means to avoid doing all that can be done now.

The association supports decontrol through means that do not involve unilateral contract abrogation, but we recognize the vulnerability of pricing components to the emotional and political factors mentioned above, but nonetheless we feel and the association does on balance that if decontrol can be achieved, it should be done because there is no better time. The markets are such that to the extent that there is a consumer impact, it will be lower prices over time, and it will not make that much difference to the producing sector, which is in a very depressed state at the moment.

In addition, we support and urge enactment of the nonprice elements of repeal of the Fuel Use Act and incremental pricing, a statutory mandate for nondiscriminatory transportation for Federal royalty, that is, royalty paid on Federal leases, to be based upon the actual price received rather than some fictitious market price conjured up by Federal officials.

Fourth, that specific antitrust exemption for independent marketing cooperatives be inserted. This is a provision that has been in previous versions of legislation considered by this committee, and it would simply be a clarification and an assurance that such marketing cooperatives would not run into antitrust problems.

Fifth, revision of gas importation authority and its implementation at the present time, as has been previously mentioned, gas is being imported from Canada, and there is not a fair opportunity for domestic producers to compete for the markets that that gas is being delivered to primarily or particularly in California. The regulatory process both at the Federal level in the FERC and the ERA and at the State level is such that there is an actual preference for Canadian gas, seemingly on the notion that we will keep our domestic gas in the ground, and we will use it when it is harder to get or imported gas is more expensive.

Finally, we urge that there be no statutory bailout of pipeline's take-or-pay obligations. The previous panel and you, Senator, discussed that considerably. We certainly hope that the committee will not buy the proposition that comprehensive legislation should be conditioned upon bailout for pipelines of their take-or-pay obligations.

In summary, we urge that all these elements be earnestly considered for inclusion in near-term natural gas legislation, and hope they will be a part of any enactment of natural gas legislation by the 99th Congress. They are all critical to independence, and it is our opinion that each component is sufficiently significant to stand alone as a worthwhile legsilative enactment if that is necessary. We urge the Senate Energy Committee and the Congress to do all that can be done now, and if more remains to be done in the future, get to work laying the foundation for new efforts in the 100th Congress.

If any New Mexico independent gas producers are still around then, we would stay involved and be supportive in that effort.

[General laughter.]

Mr. GENTRY. Thank you.

[The prepared statement of Mr. Gentry follows:]

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

May 20, 1986

STATEMENT OF R. CHARLES GENTRY REPRESENTING THE INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO

"EFFECTIVE NATURAL GAS LEGISLATION"

My name is Charles Gentry. I am an attorney with the law firm of Shank, Irwin and Conant of Dallas, Texas. I have for several years represented the Independent Petroleum Association of New Mexico on a wide range of energy and public lands issues, including natural gas regulation and legislation.

The Independent Petroleum Association of New Mexico has been comprised until recently of over 700 independent producers and royalty owners of crude oil and natural gas produced primarily in New Mexico. The association's active membership has been substantially reduced during the last several months due to the disastrous conditions faced by the domestic oil and gas industry. The situation faced by New Mexico gas producers is even more severe, since the primary market for their gas is California, where extremely adverse market conditions, a perverse regulatory structure and an undisguised preference for Canadian gas, even at higher prices, make it almost impossible to continue to sell significant volumes of New Mexico gas at acceptable prices.

Against this rather bleak background, New Mexico independents are desperate for some relief, any kind of relief, and the sooner, the better. That is the background from which these remarks are made for the purpose of identifying the components of natural gas legislation which New Mexico independents feel would be helpful and which they support.

Before listing those components and describing each to a limited extent, New Mexico independents feel a couple of preliminary observations are in order. First, we realize that legislators need more than just a "laundry list" of legislative measures that would be helpful to any particular interest group. You need an indication of the relative priority attached to each item on the list, as well as an indication of whether each item is related to immediate problems or more applicable to longer term matters. These details are necessary because the legislative package designed for any set of problems inevitably falls short of addressing every problem or containing all desirable components.

Second, we recognize that natural gas legislation is always burdened by emotional and political counterforces that complicate and delay the legislative process and generate irrational reactions such as that exemplified by that famous statement attributed to a member of a congressional committee of jurisdiction: "Over my dead body!"

Mindful of these political and emotional factors superimposed over the present inquiry about what the Congress ought to do about natural gas, this presentation will focus on two major categories of legislative initiatives: (1) those involving pricing issues and (2) those involving non-pricing issues.

Pricing Issues

It is the perception of New Mexico independents that the elements of natural gas legislation that would most likely lead to excessive delays and complications are those involving pricing issues. In fact, the quote previously mentioned was directed to deregulation of old gas left under price controls by the NGPA. It is for this reason that we discuss pricing issues separately, since provisions intended to effect removal or reduction of price controls may still be so objectionable to significant congressional forces that their presence in a legislative package may spell doom for that package.

New Mexico independents support the Administration's goal of price decontrol of all natural gas. We hope the Committee will review all bills before it to devise an effective decontrol proposal and urge its enactment. There has never been, and we hope there will never be, a better time for removing all wellhead price controls and we believe the Administration's proposal is fair and workable. To the extent that it would have an impact on consumer prices, it should cause even lower prices over the long term. This is true because some old low-priced gas that might never have been produced would have a better chance of being produced and would be sold for less than newer gas that would have been produced and sold in its place if the old gas had been shut-in and abandoned.

Although independents as a general rule do not have as high a percentage of old gas as the majors, most independents are quite willing to endure whatever further disadvantage may flow from this version of decontrol in order to put the sorry history of wellhead price controls behind us, hopefully forever. This is not "decontrol through total contract abrogation" that the Administration proposed and New Mexico independents opposed several years ago, a proposal whose solution was worse than the problem it addressed. The time for total decontrol has long since past and market conditions couldn't be better, so we hope it can be done now.

If the politics and practical limitations at this juncture are such that price decontrol cannot be achieved, we are faced with yet another widely-believed perception that has become pretty firmly established as part of the congressional folklore related to natural gas legislation. I am speaking of the well-advertised perception that a majority of legislators, after enacting even the most trivial natural gas legislation, will totally reject any attempt within the next several years to again become involved with natural gas legislation. New Mexico independents have no direct knowledge of the actual impact of this phenomenon and realize its reality is something each legislator must decide for himself or herself and each committee must decide for itself. In any case, we strongly urge that natural gas legislation be pursued which is as broad as possible, covering those elements which can give some immediate relief, and hope for the future, to a beleaguered industry.

Non-Price Issues

1. Elimination of End-Use Restrictions - The Fuel Use Act was predicated on an entirely false se of assumptions about the limited reserves of domestic natural gas. It is a hand-me-down of the restrictive price control policies of the Natural Gas Act and serves no good purpose. It should be repealed. We do not seek to have natural gas be given any kind of preference in those uses to which this law applies, only that the counterproductive artificial restraints on gas use and unwarranted preferences for other fuels be eliminated. In an era where we are drowning in a sea of natural gas, it makes no sense to prevent or limit the use of gas in any manner the market determines to be economically feasible.

Likewise, Title II of the NGPA, Incremental Pricing, should be repealed. It has never served the purpose for which it was intended and now threatens to interfere with use of gas by some consumers at prices they are willing to pay, absent the effect of this statutory provision.

Immediate action should be taken to remove the artificial and totally unjustified end-use restraints of the Fuel Use Act and Incremental Pricing.

2. Statutory Mandate for Nondiscriminatory Transportation - Last year the courts put an end to the patchwork regulatory system concocted by the pipelines and blessed by the FERC to permit the pipelines to keep gas moving through procedures based upon selective discrimination against certain pipeline customers. The FERC responded to this judicial action by promulgating Order No. 436, an order intended to impose on pipelines that want to receive the benefits of routine transportation of third party gas, the conticomitant requirement to provide open and equal access to transportation, free of discrimination. That order was warmly received by the producing sector and promised to provide the means for genuine and fair competition from the wellhead to the burner tip. Unfortunately, those promises have gone a glimmering, torpedoed by the interstate pipeline system which has forced the FERC to adopt an implementation system that not only permits continued discrimination, but one which institutionalizes discrimination.

Our purpose is not to castigate the FERC, but to report that the pipelines and their large LDC customers have used the voluntary nature of Order No. 436 to convert this program to a vehicle for continued domination of the gas industry by middlemen. The Administration's bill gives the FERC the authority to make nondiscriminatory transportation mandatory, rather than voluntary, and permit producers to compete for markets now the exclusive domain of interstate pipelines, their marketing affiliates and the large LDC's. This remedial action is extremely urgent and should be included in any legislative package produced by the Congress.

3. Federal Royalty Based on Price Received - Many in Congress will find it almost unbelievable that the federal government, while actively pursuing the lowest possible prices for natural gas, insists that lessees of Federal leases pay royalty based on a higher price than actually received in arms-length transactions. In effect, this permits the government, as lessor, to demand that lessees pay a higher effective royalty rate than specified in the lease.

Take this typical example: A lessee's gas qualifies as Section 102 gas for which the lessee had been receiving the 102 price until forced by the pipeline to accept price reductions in order to keep some gas flowing. It is not unusual for the government to demand royalty payment calculated as the lease's specified percentage of the current Section 102, or some other price considered sufficient to reflect the "market value" of the gas. This is yet another example of our convoluted, disjointed regulatory system which forces producers to bear the entire burden of poor gas markets.

The solution is simple. In the absence of fraud or collusion, the government (or the Indian Tribe, if a Tribal lease) should either accept the actual selling price for the purpose of royalty calculations or it should exercise its right under the lease to take its royalty share in kind. By this simple method, if the government or Indian Tribe can get a higher price than the producer/lessee, the U.S. treasury will benefit, but if it can't, the producer/lessee has not been forced to pay a higher royalty rate than called for in the lease. If it takes an Act of Congress to put an end to this unfair practice, which does not benefit gas consumers at all, so be it.

4. Antitrust Exemption for Independent Marketing Cooperatives - While many people believe that our antitrust laws do not prohibit the formation and operation of producer cooperatives solely to market natural gas, any doubts would be resolved by legislation designed for that purpose. Smaller producers usually do not control enough gas to justify the expenses involved in trying to sell to purchasers other than the pipeline that runs by the lease. Obviously, if a number of smaller producers could form and operate a marketing cooperative, they could put together packages of

gas large enough to interest end-users at a distance and justify marketing expenses to be shared by members of the coop.

This clarifying legislation is very simple, should be noncontroversial and has been included in previous legislative proposals. The independents of New Mexico urge its inclusion in any legislative measure produced by the Congress.

5. Critical Review of Gas Importation Authority and Its Implementation - Domestic producers are being shut out of many markets because the combination of federal and state regulatory structures permits imported gas to be shielded from competition by domestic gas. Part of the problem is at the FERC, where a pricing structure for resale of Canadian gas, the so-called "as-billed basis," permits certain costs of Canadian gas to be disregarded when price comparisons are made. The result is that Canadian gas is often sold to, and consumed by end-users, at final burner tip prices in excess of domestic gas rejected due to the erroneous price comparison previously mentioned.

Part of the problem is at the Economic Regulatory Administration, the ERA, which, in the name of free trade, has totally abdicated its statutory responsibility to insure that importation authority is granted only to those applications which are shown to be in the public interest. In a typical example of this Administration's promotion of political theories over economic reality and the true public interest, the ERA has effectively shifted the burden to those who question import applications to demonstrate that they are not in the public interest.

The most vivid example of this circumstance is the ERA's position that importing pipelines do not have to be open access carriers under Order No. 436, unless it can be demonstrated that open access compliance will achieve greater competition in the marketing area in question. The result is that interstate pipelines can import Canadian gas and sell it to their market areas without domestic producers having any opportunity to compete for those markets unless domestic producers meet the test just described. Domestic producers do not seek protection of either price or territory, but they do seek, and have the right, to be able to compete on a fair and equal basis with imported gas.

This unfair competition is especially prevalent in California where the principal LDC's have affiliate relationships that are promoted by the transportation and sale of Canadian gas, even when it turns out to be more expensive than readily available domestic gas. Also in California, the state regulators and the consuming public have in mind to use Canadian gas now, while it is relatively cheap and plentiful, and relegate New Mexico producers to providers of free storage. Sadly, the current federal regulatory structure enables the

Californians to do just that, adding to their conviction tha New Mexico gas is theirs anytime they want, at any price they want. But, really, who can blame them for this belief, since it has so much basis in fact and is firmly anchored in the history of price regulation. After all, from 1938 until 1985, thanks to federal price controls, Californians paid New Mexico producers far less for natural gas than its true market value. For almost 50 years, Californians have been living off cheap New Mexico gas, an addiction that appears very difficult to break.

To address these problems, New Mexico independents urge that any natural gas legislation contain provisions which:

a. Require that federal regulations pertaining to resale pricing structures be devised so that all costs of imported gas are revealed for accurate price comparison purposes. Further, specify that it shall be unlawful for domestic gas available at a true cost less than imported gas to be rejected in favor of higher-priced imported gas.

b. Direct the ERA to require applicants for importation authority to demonstrate that the requested authority is indeed in the public interest, not just that it can be sold somewhere in the U.S. Specifically, the ERA should be directed to deny importation authority to any pipeline that has declined to become an open access carrier, or that is served by any pipeline transporting the imported gas that has declined to be an open access carrier.

6. Refuse to Enact a Statutory Bail Out of Take-or-Pay Obligations - The interstate pipelines and their associations continue to stir the pot by exaggerated claims that take-or-pay obligations are unfair, have direct impact on residential gas consumers and will bankrupt a number of pipelines. It should be remembered that the people circulating these stories are the same folks who told Congress and the nation, starting in 1982, that NGPA decontrol on January 1, 1985, would produce a "price spike" that would devastate the gas consuming public. They were wrong then and they are wrong now, but I believe there is a difference. As to their prophecy of a runabout price spiral after decontrol in 1985, I think they actually believed that might happen. Their trumped-up claims about the disastrous consequences of their take-or-pay obligations is pure fraud and they know it.

Let there be no mistake, the pipeline sector of the industry, with lobbyists and lawyers paid by their customers, have thus far been able to avoid shouldering any significant part of recent and current gas market problems and they expect Congress to relieve them of any burden whatsoever, in the form of unilateral contract abrogation to the detriment of producers. Let producers bear this burden, too. Don't ask the pipelines, nor their shareholders, who have habitually been shielded from every conceivable business risk, to make good on contract obligations, bargained for in good faith by producers.

The pipelines promote misconceptions and distortions about the true nature of take-or-pay obligations. Such payments are actually advance payments for gas contracted for, but not taken, with the right to take that gas in the future. They can be thought of as the use of money by the producer for storing that gas or keeping it in reserve until it is needed by the pipeline. This is not an unusual arrangement and has been a part of industry contracts for many years. No outside tampering on behalf of the pipelines is necessary or justified.

Another distortion pipelines promote is the magnitude of these payments, while yet another is the actual extent of rather extensive contract renegotiation. For example, a particular pipeline has claimed for several years that its take-or-pay obligations through calendar year 1986 ran into hundreds of millions and even billions of dollars. Yet in information just furnished to the FERC, that pipeline revealed that to the end of February, 1986, it had paid producers only about $91 million in take-or-pay payments, a settlement rate of about 27¢ on the dollar. Renegotiation has been and is going on and lawsuits have been and are being settled on terms that are more than fair to pipelines. The FERC, to its credit, has thus far refused to bail out pipelines with respect to their take-or-pay obligations and Congress should do likewise. Most important, the Congress should not take the bait dangled by the pipelines that they will trade their support for legislation encompassing decontrol and/or mandatory nondiscriminatory transportation in exchange for elimination of take-or-pay problems. Remember that same ploy by these same entities from years past in the context of having to get "relief from 'problem contracts'" as the only way to prevent the debilitating price spike sure to follow decontrol pursuant to the NGPA.

Summary of Position on Natural Gas Legislation

This statement has become far too long, necessitating a brief summary of the view of the Independent Petroleum Association of New Mexico with respect to natural gas legislation.

The Independent Petroleum Association of New Mexico recognizes that the congressional folklore indicates that natural gas legislation is such an emotional and politically difficult issue that two competing notions are superimposed over its consideration. (1) It is a subject legislators want to take up no more often than absolutely necessary. (2) It is even more tedious and frustrating if price decontrol is involved.

The producing sector of the domestic gas industry is in big trouble and any help possible through legislative enactments is desperately needed, and the broader, the better. If the political atmosphere is such that comprehensive legislation cannot be enacted, the Congress should act now to provide that degree of relief that it is possible to achieve. The conventional wisdom which holds that, if even a limited bill passes this year, most legislators will refuse to consider natural gas legislation next year, must be dealt with at that time. That propensity should not be used as a means to avoid doing all that can be done now.

We support the Administration's proposal for effecting decontrol of wellhead prices, but recognize pricing vulnerability to the emotional and political factors mentioned above. Nonetheless, if it can be done, it should be, and others here are the best judge of that.

We support and urge enactment of the nonprice elements of:

(1) Repeal of the Fuel Use Act and Incremental Pricing;

(2) Statutory Mandate for Nondiscriminatory Transportation;

(3) Federal Royalty Based on Price Received;

(4) Specific Antitrust Exemption for Independent Marketing Cooperatives;

(5) Revision of Gas Importation Authority and Its Implementation;

(6) No Statutory Bail Out of Pipelines' Take-or-Pay Obligations.

We urge that all these elements be earnestly considered for inclusion in near-term natural gas legislation and hope they will be a part of any enactment of natural gas legislation by the 99th Congress. They are all critical to independents and it is our opinion that each one is sufficiently significant to stand alone as a worthwhile legislative enactment. We urge the Senate Energy Committee and the Congress to do all that can be done now and if more remains for the future, get to work laying a foundation for renewed efforts in the 100th Congress. If any New Mexico independent gas producers are still around then, they will stay involved and supportive.

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Senator **NICKLES**. That is not funny.

Mr. **GENTRY**. No, it is not. It is very true.

Senator **NICKLES**. Mr. Gentry, thank you very much.

Senator **DOMENICI**. Senator, would you mind if I asked some questions?

Senator **NICKLES**. Go right ahead.

Senator **DOMENICI**. I do want to apologize to much of the panel, but I want to ask the New Mexico representatives a few questions. It will not take me too long, I hope.

Mr. Gentry, I was being facetious with you in terms of how you know so much about how we feel you were here long enough to know. You lived through the Natural Gas Deregulation Act with me. We were in conference 18 months, and we produced a turkey, as I recall.

Mr. **GENTRY**. Yes, several.

Senator **DOMENICI**. Senator Johnston was with us and against us, depending upon how close we were to Thanksgiving, I think, and that also came out close to an election or something, but in any event, let me ask you, do I understand that the New Mexico independents, the last time we considered decontrol, were opposed to the bill on the abrogation aspects, one principal objection. They sort of stood alone at first, and it seemed to me that their objection caught fire, and before we got to the floor of the Senate, substantial numbers of the independents across the country joined in that concern.

Now, I read your statement briefly, and I just listened to your summary remarks, and I am slightly confused, because it appears to me that you now say you support the DOE bill as it pertains to deregulation. You obviously support it on its transportation ingredients. That has been consistent. But do our New Mexico independents support the DOE deregulation, and if they do, how is that consistent with saying you oppose abrogation?

Mr. **GENTRY**. Well, Senator, with respect to the transportation component, let me address that first. You are absolutely right. The transportation component is one that I suppose there has never been any kind of waivering in the position of the New Mexico independents, although at first many of them were reluctant to get on board with contract carriage movement because most—some believe that before long it would become a means by which the pipelines would just change another regulatory structure to their advantage, and to some extent they have been proven right, but on transportation certainly that support is consistent.

With respect to the decontrol features, I believe it is accurate to say that the Independent Petroleum Association of New Mexico has never been against total decontrol per se. In S. 615 and the bill reported out of this body, S. 1715 maybe two Congresses ago or the last Congress, the primary means of decontrol was through contract abrogation in which every contract between pipelines or between producers and purchasers would have been subject to being abrogated by one party or the other, and the producer would have had no protection as to the price or the terms of the contract that he had negotiated in good faith.

There are some elements of that, true, and the administration's bill does not go nearly that far. There is less of that in the other bills proposed, and the one by Senator Nickles, so let me say that with regard to the notion of decontrol of natural gas, the Association of New Mexico Independents is in support of that, and feels that it should be done, get the whole history of natural gas price control regulation behind us.

Senator DOMENICI. Let me ask you two other questions. With reference to transportation legislation, is it not true that there is a mixed history out there as to pipelines carrying gas for others in some aspects of this in New Mexico are indeed working well. Substantial portions of gas are being delivered by El Paso, for instance. That is contract. They are permitting it to be carried because they have excess. Do I understand nonetheless that you agree with those who have testified that say it is not working across the country under the present regulatory scheme, and that we ought to go ahead and fix it at this point as part of deregulation?

Mr. GENTRY. Yes, I believe that is a fair statement of the position. There may be instances, limited instances in which transportation is working as envisioned under the concept of mandatory contract carriage without discrimination. Those instances are in the minority rather than the majority. In New Mexico we have the further complication that the gas is sold in California, where market conditions are rather unique, but, well, to carry that a step further, and those unique market conditions and the California regulatory system itself put some restrictions, limitations, and some unusual requirements on the interstate pipelines servicing or serving California.

But it is working in some instances. It is not working across the board. One of the ways in which it is not working is that pipelines can import gas from Canada. This is not the case in New Mexico where El Paso has become an order 436 carrier, but pipelines can get import authority to import gas from Canada at the same time that they have not become order 436 carriers, and therefore the producers that sell to that pipeline are unable to compete with those same markets that the Canadian gas is going to be sold to.

In short, the independents support a statutory provision where they would debate over whether it is undue discrimiation or discrimination. I believe that is not the important feature. The important feature is that it is mandatory. Pipelines should not have the option whether to join or not, because they use that option as leverage by which to gain the settlement provisions and the settlement terms that they want. It was stated here previously that everyone has an opportunity to participate, but you have got to remember that the pipeline, before it will accept what everyone agrees to ultimately, has the ultimate hammer. They can decline to take the settlement, and decline to accept 436 requirements.

Senator DOMENICI. One last question with reference to international trade and Canada in particular, do the present FERC enabling statutes permit FERC to pass judgment on the status of an industry that is delivering from Canada such as to inquire as to who owns the production versus who owns the pipeline versus a distribution company in this country who might own a piece of it? We passed statutes and implemented them that try to distinguish those aspects wherein they might create some discrimination in favor of the pipeline because they both own production. They deliver.

I have a hunch that there are some similar situations in Canada wherein California entities own pieces of the system up in Canada, and I just want to know whether you know, can FERC inquire as to those, and if they can, who can cause them to, and if they cannot, should we enable them to?

Mr. GENTRY. I do not know whether the FERC or the ERA can inquire as to those details to which you refer.

I think that the ERA should be able to have that information provided in importation authority and if it is there, the extent to which they can consider it in making their decision, I am not sure. But it certainly seems to me that that would be a reasonable requirement and if it is not now within the scope of their inquiry, certainly we would think that it should be.

You are absolutely right that there are some affiliate relationships between California distributors and pipelines transporting gas from Canada and in Canada and perhaps even Canadian production affiliates that does not meet the eye when you look at price comparisons and other things in the California market.

Senator DOMENICI. Wherever I said FERC, I would include FERC and/or ERA and you have answered it appropriately, and I thank you for that.

Thank you very much, Mr. Chairman.

Senator NICKLES. Senator Domenici, we are happy to accommodate you.

Our next panelist is Jack Graves, who is president of Calumet Oil Co. from Tulsa, OK.

Mr. Graves.

STATEMENT OF JACK GRAVES, PRESIDENT, OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION

Mr. GRAVES. Mr. Chairman, Senator Domenici, I am Jack Graves, president of the Oklahoma Independent Petroleum Association and president of Calumet Oil Co. On behalf of the 1,500 members of the OIPA, we feel honored to be here and appear before you and this committee to talk about these important natural gas issues. With me today is David House, chairman of OIPA gas committee, and vice president of Sampson Resources Co.

The problems in the gas industry are mounting, both for the producers and the consumers. Since 1981, OIPA has made several appearances before this committee, as well as other Senate and House committees and Federal agencies, to discuss the problems, suggest recommendations, and to seek answers and actions.

Senator Nickles, Oklahomans have been extremely fortunate to have you, our own Senator, leading our efforts, working by our side, and sharing our hopes that the Senate, the House, and the administration will come to terms on programs that will bring stability to the gas industry and the gas producer.

Senator NICKLES. Do you want to pull the microphone up. I want to make sure everybody hears that. [Laughter.]

Mr. GRAVES. Would you like me to repeat it?

Senator NICKLES. No.

Mr. **Graves**. For the record, however, we express our appreciation to and for you, Senator Nickles, for all you have done to help secure the future energy for our State and country.

The issues confronting the gas industry today are complex. OIPA has wrestled with the issues for many hours, working to establish policies and develop solutions. Achieving a consensus sometimes seems as challenging as the issues themselves. However, because the issues are so important, OIPA has hammered out a position. It is the policy of OIPA to bring about a stable and viable domestic gas industry. To accomplish this objective, OIPA asks for the elimination of excessive tariffs which inhibit the producers' ability to deliver adequate supplies of gas.

The benefits promised by FERC when it issued order 436 have not been realized and, in OIPA's estimation, will not be realized. What was purported to be a major step toward open access transportation has been negated by a series of regressive steps which have been disruptive to the industry.

We producers were supposed to know in December 1985 which pipelines would offer indiscriminate transportation. Because of Commission postponements, we will not know until July 1, if then.

Unrestricted access to reasonably priced transportation is the gas producer's number one priority. Therefore, upon review, if a proposal for contract carriage is found to provide such access, OIPA will support it.

We need acknowledgement of the many risks associated with the exploration, development, and production of gas and the need to preserve current tax laws which enable producers to realize a return commensurate with those risk factors. Attacks on the producers' continued ability to generate revenue necessary for future exploration and development are a serious threat to the gas industry, and OIPA will continue to lobby for present tax law. And it really cannot be considered separate from the purpose of this committee meeting today.

We also recommend repeal of the Fuel Use Act of 1978. The act restricts the consumers' ability to freely select a fuel which is in plentiful supply. Such consumption restrictions are costly to consumers and producers.

The repeal of all well-head price controls is needed. Such controls restrict price and alternately punish producers of old gas and producers of new gas. The Natural Gas Policy Act of 1978 gave incentives to find new gas and severely limited the potential revenue from sales of old gas. Now the block billing portion of 436, if it is put into effect, will force new gas to take a back seat in favor of old gas.

Of course the producers favor the question on the take-or-pay clauses. Some pipelines who want out of those contracts would like nothing better than for Congress to legislatively tear up the contracts.

The Federal court rulings have now neutralized the States' authority to regulate the ratable production of gas under the States' long-established sovereignty to protect correlative rights and prevent waste. These decisions have further created a disorderly gas market.

We think a stable industry would enable the producer to make long-range decisions and commitments with a high degree of certainty which we have not had and apparently will not have in the future.

Before hearing from Mr. House, I would just like to add that most of my current industry activity focuses on crude oil production. Some may question my next statement, given the problem that oil producers have, but I am extremely thankful the crude oil market is not regulated like the gas market. I would gladly and will gladly take my chances with OPEC pricing than live as the independent gas producers do with the current regulatory burden, maze, and uncertainty whether management decisions made today will be rendered meaningless by bureaucratic fiat. The independent gas producers daily spend useless hours tilting the windmill, just as Don Quixote did.

Again, Mr. Chairman, OIPA asks for prudent and prompt action to alleviate the turmoil of errant regulations and vast uncertainty.

We thank you for this opportunity to appear before this committee.

[The prepared statement of Mr. Graves follows:]

COMMENTS OF MR. JACK GRAVES, PRESIDENT
OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION

Mr. Chairman, members of the committee, good morning...

I am Jack Graves, an independent producer from Tulsa, Oklahoma, and president of OIPA, the Oklahoma Independent Petroleum Association. Once again, on behalf of OIPA's 1,500 members, I am honored to appear before you and the committee to discuss important natural gas issues.

Problems in the gas industry are mounting, both for producers and consumers. Since 1981, OIPA has made several appearances before this committee, as well as other Senate and House committees and federal agencies, to discuss gas industry problems, suggest recommendations, and to seek answers and action.

Throughout the same five years, Oklahomans have been extremely fortunate to find our own senator, the Honorable Don Nickles, leading our efforts, working by our side and sharing our hopes that the Senate, the House of Representatives and the President will come to terms on programs that will bring stability to the gas industry.

For the record, Mr. Chairman, we express our appreciation to and for Senator Nickles, and for all he has done to help secure the future of energy for our state and country.

The issues confronting the gas industry today are complex. OIPA has wrestled with the issues for many hours, working to establish policies and develop possible solutions. Achieving a consensus sometimes seems more challenging than the issues themselves. However, because the issues are so important, I am proud to say OIPA has hammered out a position which we believe is worthy of your consideration.

It is the policy of OIPA to work to bring about a stable and viable domestic natural gas industry. To accomplish this objective, OIPA shall labor ardently for:

> 1) Elimination of excessive tariffs which inhibit producers' ability to deliver adequate supplies of gas to consumers. The benfits promised by the Federal Energy Regulatory Commission when it issued Order 436 have not been realized, and, in OIPA's estimation, will not be realized. What was purported to be a major step toward open access transportation has been negated by a series of regressive steps which have exacerbated the disruption in the industry. We producers were supposed to know, in December 1985, which pipelines would offer indiscriminate transportation. Because

of Commission postponements, we won't know until July 1st, if then. Unrestricted access to reasonably-priced transportation is the gas industry's number one priority. Therefore, upon review, if a proposal for "contract carriage" is found to provide such access, OIPA will support it.

2) Acknowledgement of the many risks associated with the exploration for and the development and production of gas, and the need to preserve current tax laws which enable producers to realize a return commensurate with those factors. Attacks on producers' ability to generate revenue necessary for future exploration and development are a serious threat to the gas industry, and OIPA will continue to lobby for present tax law.

3) Repeal of the Fuel Use Act of 1978. The Act restricts consumers' ability to freely select a fuel which is in plentiful supply. Such consumption restrictions are costly to consumers and producers.

4) Repeal of all wellhead price controls. Such controls restrict price and alternately punish producers of "old gas" and producers of "new gas." The Natural Gas Policy Act of 1978 gave incentives to find "new gas" and severely limited the potential revenue from sales of "old gas." Now, the Block Billing portion of Order 436, if it is put into effect, will force "new gas" to take a back seat in favor of "old gas."

5) Preservation of contract sanctity. Recent court cases have put teeth back into contracts by ruling in producers' favor on the question of take-or-pay clauses. Pipelines who want out of those contracts would like nothing better than for Congress to legislatively tear them up. Also, contract sanctity would further insulate consumers from any price fluctuation if wellhead decontrol is enacted. We emphasize that if there is decontrol, there must be contract sanctity.

6) Federal court rulings have neutralized states' authority to regulate the ratable production of gas under states' long-established soverignty to protect correlative rights and prevent waste. The federal decisions have created a disorderly gas market, and have impaired individuals' and states'

property rights. OIPA is committed to correcting this situation.

7) Enable producers to make long-range decisions and commitments with a high degree of certainty the industry will not be inflicted with radical changes. On January 1, 1985, the industry entered into partial wellhead decontrol after seven years of total control. Then, in October 1985, we were hit with Order 436 which gave us new rules for the same game. Each day, independent gas producers wonder what will come next. Stability is vital to the future of the gas industry. Once the changes needed today are enacted, let's leave the industry alone so it can meet consumer demands in the years to come.

Before asking Mr. David Bouse, Chairman of OIPA's Natural Gas Policy Committee, to provide more details about our position, Mr. Chairman, I would like to add that most of my current industry activity focuses on crude oil production. Some may question that statement, given the problems oil producers have. But, I am extremely thankful the crude oil market is not regulated like the gas market. I would rather take my chances with OPEC than live, as independent gas producers do, with the current regulatory burden and uncertainty whether a management decision made today will be rendered meaningless by bureaucractic fiat.

Again, Mr. Chairman, OIPA asks for prudent and prompt action to alleviate the turmoil of errant regulations and vast uncertainty.

We thank you for the opportunity to appear; and we thank Sentor Nickles for helping arrange it.

Senator NICKLES. Thank you very much, Mr. Graves.
Mr. House.

STATEMENT OF DAVID HOUSE, CHAIRMAN, NATURAL GAS POLICY COMMITTEE, OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION

Mr. HOUSE. Good morning, Senator Nickles. I am David House, chairman of the OIPA's gas committee with Sampson Resources out of Tulsa.

Our purpose here today is really to comment on a series of legislative proposals that can be lumped into three broad categories: consumption restrictions, transportation restrictions, and price restrictions. It is the view of the OIPA and the gas committeee of that organization that clearly the most critical of these at this particular time is that of transportation restrictions.

The past several years have seen willing buyers and sellers maneuver their way through a regulatory morass and pipelines' self-imposed rules to consummate a significant number of industrial sales transactions. Unfortunately, the DC Circuit Court said that these types of transactions were illegal, and even more unfortunately they did not really give us any clear-cut method as to how to make them legal.

Under the court-mandated time pressure, the FERC issued a sweeping set of rules which were eventually boiled down to orders 436 and 436A, which supposedly would usher the pipelines and the producers and the consumers into a new era of pipelines entering into transportation as opposed to their historic merchant function.

After 8 months under this rule, not a lot has been accomplished. It is true that a lot of gas is moved, but most all of it has been through grandfathering provisions under section 311, through shadow pipelines, or other special considerations. The FERC has shown a willingness to approve section 7 applications for transportation, even though they clearly defeat the purpose of open access to pipelines.

The regulatory body and the pipelines have had adequate time to craft appropriate tariffs, terms, and conditions which would support a nondiscriminatory access to transportation. Instead, we have seen a number of these so-called open access filings being heard in rate cases where the producing segment is not always well represented. Only through aggressive intervention have producers been able to convince FERC to listen to our side of the issues.

If I may expand a little bit on what Jack referred to, the tariffs and conditions that the pipelines generally are proposing are so restrictive that they really discourage transportation as opposed to encouraging it. A specific example is the feed that is being proposed on almost all of the rate cases for very narrow system daily imbalances. This is a situation where, if I were selling to an end user and he burned a thousand mcf today, and I delivered him 1,020, then I would have to possibly pay a charge of between $5 and $10 an mcf for that imbalance.

I submit that the pipelines do not even have the ability to measure that accurately and that these type of restrictions are in effect discouraging significant transportation from happening.

In closing my remarks on the transportation portion, let me emphasize that the lack of nondiscriminatory open access hinders many buyers and sellers of gas today. OIPA would support transportation which gives a clear signal to the people involved to be a transporter or do not be a transporter.

I think it is clear from the earlier panel that the pipelines think it is working, but for some reason we producers and the consumers do not get that idea. I think that gives you an indication of what is happening.

I will briefly address the other issues that have been brought here and discussed fully today. One of those is restrictive consumption. I think it would be silly for our friends in the farming business to be told that they could not use their wheat to make bread with. It is OK to make pasta and cupcakes and pies and whatever, but they cannot make bread with it.

We have a similar situation in the producing industry today that in many cases is difficult for us to use natural gas for its chief purpose to make power with. And I think that obviously OIPA, as well as practically everyone, supports the repeal of those restrictions. Even if, as Senator Bumpers alluded to earlier, the comprehensive legislation is not possible, we certainly would all support that in and of itself, by itself. We do support comprehensive legislation. But if that is not a reality, then we would support just restriction removals.

The third issue that has been discussed at great length this morning is that of pricing decontrol. Briefly, the OIPA has historically and continues to support the broad principles of free market. We think that it would be totally improper though for that to be brought about in such a way to abrogate existing contracts and I think that the abrogation of contracts is a principle that cannot be compromised, anyway.

Thank you for your time.

[The prepared statement of Mr. House follows:]

OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION
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Before The

UNITED STATES SENATE
COMMITTEE ON ENERGY & NATURAL RESOURCES

THE HONORABLE JAMES A. MC CLURE, CHAIRMAN

Comments Of:

MR. DAVID HOUSE, CHAIRMAN
NATURAL GAS POLICY COMMITTEE
OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION
(OIPA)

May 20, 1986
Washington, D.C.

Thank you, Mr. Chairman. I am David House, Chairman of OIPA's Natural Gas Policy Committee and Vice President of Administration for Samson Resources Company, a large independent natural gas producer based in Tulsa.

Our purpose here today is to comment on a series of legislative proposals which deal with a number of complex and important issues. These issues can generally be lumped into three (3) broad categories: consumption restrictions, transportation restrictions, and price restrictions. It is the view of the OIPA that the most critical of these at this time are the transportation restrictions.

The past several years have seen willingly buyers and sellers maneuver their way through a regulatory morass and pipelines' self-imposed rules to consummate a significant number of industrial transactions. The D.C. Circuit Court said these types of transactions were illegal. Unfortunately, the Court did not have any idea how to effect the transportation in a legal manner. Under the Court-mandated time pressure, the FERC issued a sweeping set of rules which eventually boiled down to Order 436 as we refer to it in the industry today. Order 436 and 436A is a several hundred page document which theoretically gives us a method which will replace SMP's, and usher the pipelines into a new era of transportation versus merchant functions.

As we approach eight months since the infamous October 9, 1985, date, not a lot has been accomplished. We have been through two missed deadlines, and July 1, 1986, possibly will be a non-event also. In the interim, a lot of gas has moved, no doubt about that, but it has all been through "grandfathering", shadow pipeline or other special consideration situations. The FERC has shown a willingness to approve Section 7 applications for transportation, even though they clearly defeat the purpose of open access to pipelines. The regulatory body and the pipelines have had adequate time to craft appropriate tariffs and terms and conditions which will support a non-discriminatory access to transportation. Instead, we have seen a number of "open access" filings decided in "rate cases", where the producing segment is not allowed to attend "settlement conferences" on matters which greatly affect their long term survival. Only through aggressive intervention and demands have producers been able to convince FERC to listen to our side of the issues.

The tariffs and general conditions the pipelines are proposing are generally so restrictive as to really discourage, not encourage, transportation. While the pipelines certainly have every right to protect their system, charges of $5.00 and $10.00 per MMBTU for very narrow daily imbalances are unduly restrictive, and in fact discriminatory. It is a fact that these charges have been common in the industry, but it is also a fact that the tariffs for over and under delivery are routinely waived in pipeline to pipeline transactions. No such generosity has been suggested to producers and end users.

In closing the transportation section of my remarks, I emphasize again that the lack of non-discriminatory, truly open access hinders many willing buyers and sellers of gas today. The

OIPA supports legislation which gives the FERC and the pipelines a clear signal to be on one side of the fence or the other: be a transporter, or don't be one. Producers can react accordingly to those situations. We cannot continue to deal in situations in which pipelines say and act like transporters, but the only gas moving is via shadow pipeline or grandfathering.

The next issue I want to address is that of restrictive consumption. If you can do nothing else, surely this body can push through a repeal of the restriction on use of natural gas. We have often heard that not much can be accomplished on natural gas because there is not a consensus in the industry. I concur that on many issues, we have different opinions, but on this issue, I know of no dissenting factions. We have an abundance of gas, as does Canada, and to still have the ill-conceived idea to restrict the use of gas is totally inappropriate. It would be silly to think that our friends in the farming business had to contend with a law that said you can't use wheat to make bread. Its OK to make cakes, pies, muffins, and pasta, but no bread. I think the gas industry is saddled with such a law. The OIPA totally supports, with or without any other pieces of this puzzle, removing all restrictions on the use of gas, including those on the military. OIPA therefore urges passage of S. 2205.

The third issue, which seems to get most of the attention, is that of price decontrol. The OIPA has historically and continues to support the broad principles of a free market. We always raise the warning flag however, and ask that other factors also be considered. The first is that contracts must be preserved. In our environment, contracts are currently being totally ignored by the pipelines. A typical situation is that an independent producer gets a 2-3 page letter from a vice-president of a pipeline outlining how bad things are for the pipeline. Then, 30 days later he notices that his price has dropped, whether contractually authorized or not, and/or the level of takes by the pipeline has dropped substantially. This is called renegotiation, pipeline style. Most independents do not have the legal staffs to battle these tactics, or the desire to have that type of relationship with a customer (the pipeline in this case). Therefore, most independents have renegotiated their contracts. To pass legislation which would put additional pressure on these producers would be wrong. I suggest that all gas be decontrolled, but in an appropriate manner over time so as not to cause additional dislocation to independent producers and their contracts.

In conclusion, from our point of view, the priorities have become misplaced. We need assistance on transportation, not pricing. There is a vast quantity of market-sensitive gas that is able to flow to the market, but transportation on a nondiscriminatory basis is not available. Restrictions on use are destructive to demand and growth. When we solve those problems, then let's talk about decontrol of pricing. We support S. 1302 and S. 2285, but we continue to question the priority of such legislation, versus our needs in the real world.

Senator NICKLES. Mr. House, thank you for your appearance before the committee, again.

Our next panelist is Joe Hargrove, independent producer from Baton Rouge, representing Louisiana Association of Independent Producers and Royalty Owners.

Mr. Hargrove.

STATEMENT OF JOSEPH L. HARGROVE, VICE PRESIDENT, LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS

Mr. HARGROVE. Mr. Chairman, Senator, I am Joseph L. Hargrove, an independent oil and natural gas producer from Shreveport, LA.

Senator NICKLES. Shreveport. I apologize for that.

Mr. HARGROVE. That is all right, sir.

I am also vice president of the Louisiana Association of Independent Producers and Royalty Owners [LAIPRO], for whom I speak today. We are an association of approximately 1,200 members who explore for and produce crude oil and natural gas and of some of the minerals underneath those projects.

Senator DOMENICI. Mr. Chairman, I wonder if the gentleman would just give me a moment. Since I have to leave, could I just make a statement for the record?

Senator NICKLES. Certainly, go right ahead.

Senator DOMENICI. And for your help in this matter, Mr. Chairman, I believe it is obvious from what we have heard that there probably will not be a better time in terms of the marketplace than now to seriously consider comprehensive legislation all the way from the Fuel Use Act of contract carriage amendments to deregulation, such things as royalty pricing which are absurd; nobody really believes that the Federal Government still assesses royalties based upon some fictitious standard set in some regulation. It ought to be based on what they are selling for, but all of those.

On the other hand, it appears to me that we ought to urge our chairman to proceed with dispatch or we will get nothing done, because if you look at the calendar for the remainder of this year, regardless of what we do, unless it is a bare minimum, it will be contentious not only here but on the floor and we will be competing here and on the floor for not only valuable time but time which is probably not going to be available.

So I will join with you in urging that the chairman proceed after these hearings as expeditiously as possible to move on all the bills before us, and if we can get something done, we ought to. Clearly, the concern that many had before on decontrol, other than abrogation, the concern for the consumer, at some points in history it was a valid, temporary concern. But at this point in time, it would seem that with the pressures downward, with competition from alternative sources, which is real at this point, can you imagine us ever believing that 7, 8, 9 years ago that we would have a fuel, an oil derivative delivered in California that is competing directly with natural gas for the production of electricity? We have that right now.

All of that would tend, under deregulation, to protect in the short term; but in the long term the statements here this morning are unimpeachable. When you hear people in the oil industry as independents saying they prefer the current oil market with all of the financial negatives attendant to it, they prefer that to the scheme that we have got on board over years of regulation on natural gas, it seems to me that that's a pretty imperative proposition.

Senator NICKLES. It is a pretty strong statement.

Senator Domenici, I agree with you 100 percent, and I will tell you. I have already spoken to the chairman, and it is our intention to schedule a markup as soon as possible and see if we cannot get something through and do the best we can and take what we can get.

Senator DOMENICI. Thank you very much.

Senator NICKLES. Thank you. I appreciate your participation in this morning's hearing.

Mr. HARGROVE. As an aside, Senator, since my clock gets to start over now——

Senator DOMENICI. Yes, sir.

Mr. HARGROVE [continuing]. We appreciate your interest in this. If both houses sat waiting on the other to do something, nothing would ever happen.

Senator NICKLES. That is right.

Mr. HARGROVE. And we appreciate your going to mark it up. Anyway, our spies tell us that the House might do more than just field hearings.

Senator NICKLES. I hope that is the case. I hope your spies are accurate.

Mr. HARGROVE. Me, too.

Senator NICKLES. I hope we can do more than that, too.

Thank you. Please proceed.

Mr. HARGROVE. Yes, sir.

We appreciate being given the opportunity to appear before you to comment upon the various legislative proposals pending before the committee which addresses natural gas policy. I respectfully request that the association's complete testimony be entered into the record.

Let me state first and most emphatically, that LAIPRO has always supported the total deregulation of natural gas at the wellhead, both as to price and nonprice controls. We have not and do not now waiver from that policy position. Those who perceive otherwise are simply misinformed.

In June 1946, my father who was at the time president of the American Gas Association, entered testimony at a hearing before the Federal Power Commission. Among his testimony were the following comments:

> I believe we all agree that supply and demand are the most desirable of all controls, provided (a) no monopoly exists, and (b) there is no artificial restraint of the normal operation of these factors, nor any permanent disproportion existing.
>
> While the balance between supply and demand is heavily in favor of supply at this time, 1946 remember, expansion of the markets is taking place and will continue to do so in a healthy manner unless restrained by unwise restrictions. Over a reasonable span of years, the pendulum will doubtlessly swing back and forth, affording the most desirable of all controls, supply and demand, the heritage of a free enterprise.

Now 40 years and one generation later, we are here advocating the same principles. Since at least 1954, Federal policymakers have virtually made every significant investment and economic decision for producers, pipeliners, distributors, and consumers of natural gas and the collective record of the policymakers is, to say the least, dismal.

For nearly two decades preceding the severe shortages of the early 1970's, the Federal Power Commission established price ceilings for the various vintages of natural gas based on historical costs, which failed to take into account ever-increasing finding and production costs over and above inflation. At the same time, the Commission ignored the fact that it was regulating the commodity price of natural gas, utterly without regard to the fact that it was dealing with a finite supply base. The results were inevitable: shortages.

The policy course adopted by the Congress in response to this energy crisis was, at least in retrospect, equally ill-conceived. In late 1978, then-President Carter signed into law the National Energy Act, of which the NGPA and the Fuel Uses Act were a part. The basic assumptions entertained by the Congress in fashioning the NGPA and the Fuel Uses Act were that natural gas was a resource which was all but depleted, that demand would outstrip supply through the balance of this century and that crude oil prices by early 1985 would be somewhere in the range of $50. In less than 3 years, however, all of these assumptions proved to be wrong.

The producers' response to higher wellhead prices afforded by the NGPA has resulted in an oversupply, which has persisted for over 4 years. The conservation which has occurred from higher prices has far outreached the elasticities of demand assumed by Congress. The resulting investment decisions and contracting practices of the natural gas industry as a whole, now plague the industry and are impeding its ability to compete successfully with the currently volatile liquid fuel market.

In spite of these failures, there are those who would argue for the continuation of wellhead price controls on the older vintages of natural gas and the intrusion of either the regulator or the Congress into the contractual rights of the industry participants.

The members of LAIPRO are not persuaded that the government's track record warrants another try, for it is we and the American consumer who in the final analysis must account for the errors made here in Washington. I, for one, feel that paying for these errors twice in my lifetime is enough.

As previously stated, we support the full decontrol of natural gas at the wellhead, and the sooner the better. However, the removals of control at the wellhead would not be a panacea. It is essential that producers and end-users have access to pipeline transportation at reasonable rates. The need is not being met adequately by FERC order 436.

In our judgment, the order is fundamentally flawed. It seeks to induce the voluntary participation of pipelines to transport for others on a nondiscriminatory basis, but punishes those who agree to do so by permitting the pipeliners' distributor customers to unilaterally abrogate their resale contracts. This, in turn, is resulting in settlements between pipelines and distributors that deprive producers and end-users of practical access to meaningful transportation.

Of course, we support the repeal of all end-use restrictions upon the consumption of natural gas, namely the repeal of the Fuel Uses Act and the repeal of the incremental pricing provisions of the NGPA.

In our judgment of the various bills pending before this committee upon which we have been asked to comment, S. 2285, the administration's comprehensive bill, best fulfills our suggested solution to the currently disordered natural gas market It removes all wellhead controls on a timely basis. It empowers the FERC to mandate pipeline transportation on a nondiscriminatory basis, without the abrogation of the pipelines' resale contracts, and it repeals the Fuel Uses Act and the incremental pricing provisions of the NGPA.

Therefore, we respectfully urge this committee to mark up and report to the floor of the Senate S. 2285 at the earliest possible date.

There is, however, one problem which is not addressed by the provisions of S. 2285, which problem may be unique to smaller independent producers. That is, the need for exemption from applicable antitrust laws to the extent such producers pool their oftentimes small reserves and deliverabilities when seeking direct access to the market. Such a provision was included in S. 1715, which was reported by this committee in 1983.

Thank you, once again, for affording us the opportunity to express our views. And that is as fast as a guy from Shreveport can talk, Mr. Chairman. Thank you.

[The prepared statement of Mr. Hargrove follows:]

STATEMENT OF THE

LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS

by

JOSEPH L. HARGROVE

before the

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

on

Tuesday, May 20, 1986

I am Joseph L. Hargrove, an independent oil and natural gas producer from Shreveport, Louisiana. I am also a regional vice president of the Louisiana Association of Independent Producers and Royalty Owners (LAIPRO), for whom I speak today. We are an association of approximately 1200 members who explore for and produce crude oil and natural gas.

We appreciate being given the opportunity to appear before you to comment upon the various legislative proposals pending before the Committee which address natural gas policy.

I respectfully request that the Association's complete testimony be entered into the record.

Let me state first, and most emphatically, that LAIPRO has always supported the total deregulation of natural gas at the wellhead, both as to price and nonprice controls. We have not, and do not now waiver from that policy position. Those who perceive otherwise are simply misinformed.

In June, 1946, almost exactly forty years ago, my father, who was at the time President of the American Gas Association, presented testimony during a hearing before the Federal Power Commission. His testimony included the following: "...I believe we will all agree that supply and demand are the most desirable of all controls, provided (a) no monopoly exists, and (b) there is no artificial restraint of the normal operation of these factors, nor any permanent disproportion existing. ...While the balance between supply and demand is heavily in favor of supply at this time, expansion of the markets is taking place and will continue to do so in a healthy manner unless restrained by unwise restrictions. Over a reasonable span of years the pendulum will doubtlessly swing back and forth, affording the most desirable of all controls, supply and demand, the heritage of a free enterprise."

Now, forty years and one generation later, we are here advocating the same principles. Since at least 1954, federal policymakers have virtually made every significant investment and economic decision for producers, pipelines, distributors, and consumers of natural gas and the collective record of the policymakers is, to say the least, dismal.

For nearly two decades preceding the severe shortages of the early 1970's, the Federal Power Commission established price ceilings for the various vintages of natural gas based upon historical costs, which failed to take into account ever-increasing finding and production costs over and above inflation. At the same time, the Commission ignored the fact that it was regulating the commodity price of natural gas, utterly without regard to the fact it was dealing with a finite supply base. The results were inevitable--shortages.

The policy course adopted by the Congress in response to this energy crisis was, at least in retrospect, equally ill-conceived.

In late 1979, then-President Carter signed into law the National Energy Act, of which the Natural Gas Policy Act and the Fuel Uses Act were a part.

The basic assumptions entertained by the Congress in fashioning the Natural Gas Policy Act and the Fuel Uses Act were that natural gas was a resource which was all but depleted, that demand would outstrip supply through the balance of this century and that crude oil prices by early 1985 would be somewhere in the range of $50.00. In less than three years, however, all of these assumptions proved to be wrong.

The producers' response to higher wellhead prices afforded by the Natural Gas Policy Act has resulted in an oversupply, which has persisted for over four years. The conservation which has occurred from higher prices has far outreached the elasticities of demand assumed by Congress. The resulting investment decisions and contracting practices of the natural gas industry as a whole, now plague the industry and are impeding its ability to compete successfully with the currently volatile liquid fuel market.

In spite of these failures, there are those who would argue for the continuation of wellhead price controls on the older vintages of natural gas and the intrusion of either the regulator or the Congress into the contractual rights of the industry participants.

The members of LAIPRO are not persuaded that the government's track record warrants another try, for it is we and the American consumer who in the final analysis must account for the errors made here in Washington.

I, for one, feel that paying for those errors twice in my lifetime is enough.

As previously stated, we support the full decontrol of natural gas at the wellhead, and the sooner the better. However, the removal of controls at the wellhead would not be a panacea. It is essential that producers and end users have access to pipeline transportation at reasonable rates. This need is not being met adequately by FERC Order 436. In our judgment, Order 436 is fundamentally flawed. It seeks to induce the voluntary participation of pipelines to transport for others on a nondiscriminatory basis, but punishes those who agree to do so by permitting the pipelines' distributor customers to unilaterally abrogate their resale contracts. This in turn is resulting in settlements between pipelines and distributors that deprive producers and end users of practical access to meaningful transportation.

Of course, we support the repeal of all end use restrictions upon the consumption of natural gas, namely the repeal of the Fuel Uses Act and the repeal of the incremental pricing provisions of the NGPA.

In our judgment, of the various bills pending before this Committee, upon which we have been asked to comment, S. 2285, the Administration's comprehensive bill, best fulfills our suggested solution to the currently disordered natural gas market.

It removes all wellhead controls on a timely basis;

It empowers the FERC to mandate pipeline transportation on a nondiscriminatory basis, without the abrogation of the pipelines' resale contracts; and,

It repeals the Fuel Uses Act and the incremental pricing provisions of the NGPA.

Therefore, we respectfully urge this Committee to mark-up and report to the floor of the Senate S. 2285 on the earliest possible date.

There is, however, one problem which is not addressed by the provisions of S. 2285, which may be unique to smaller independent producers. That is, the need for exemption from applicable antitrust laws to the extent such producers pool their oftentimes small reserves and deliverabilities when seeking direct access to the market. Such a provision was included in S. 1715, which was reported by this Committee in 1983.

Thank you once again for affording us the opportunity to express our views before this Committee.

Senator **Nickles**. For a man from Shreveport, you talk very fast. Thank you very much.

Our next panelist is John Watson, senior vice president of Mitchell Energy, on behalf of Texas Independent Producers and Royalty Owners Association.

Mr. Watson.

STATEMENT OF JOHN E. WATSON, CHAIRMAN, FERC REGULATION TASK FORCE, TEXAS INDEPENDENT PRODUCERS AND ROYALTY OWNERS ASSOCIATION

Mr. **Watson**. Thank you, Mr. Chairman. As you have stated, I am appearing on behalf of the Texas Independent Producers and Royalty Owners Association, better known as TIPRO. TIPRO is composed of some 4,500 independent producers and royalty owners, most of whom have interests in or are directly involved in exploration and production of domestic natural gas.

TIPRO has historically supported the decontrol of all gas supplies and we are also concerned with the constraints on producers that relate to the lack of transportation access to gas markets and demand for our natural gas production.

The possibility of legislation in this regard in dealing with these problems is of great interest to us. We support the methodology for decontrolling natural gas that is found in Senate bill—your bill, Senator Nickles—1302, the amendments to the Fuel Use Act and the elimination of the incremental pricing also found in that bill, and the initiation of open access carriage as presented in the administration bill, Senate bill 2285. I will restrict my brief comments to these issues.

We think that Senate bill 1302 attacks the problem of decontrolling natural gas in a clean, relatively simple manner that is acceptable to most independents. The bill recognizes the sanctity of contract upon which virtually all historic gas sales are based. Gas would be deregulated when the governing contracts expire or lapse or terminate or are renegotiated under their own terms. And there would be no contract abrogation involved and no confusion with the former regulatory requirements such as are involved in the area rate matters, area rate provisions of contracts.

We feel that this approach to deregulation is preferable to that proposed by Senate bill 2285 and also to that proposed by the Department of Energy before the Federal Energy Regulatory Commission about 5 months ago. Both of those alternatives require partial contract abrogation to achieve their decontrol objectives.

The DOE proposal brings up or raises another issue that concerns small independent producers that we feel must be recognized in any attempt to decontrol all natural gas. For example, DOE attempts to raise prices of controlled gas in a regulatory framework that creates price ceilings that are above the currently perceived market clearing levels. And in today's soft market, we feel that this means that the old, lower priced gas will be negotiated upward and there will be pressure put on the high-cost incentive gas primarily owned by the independents and gas which incidentally has been discovered under the provisions of the Natural Gas Policy Act of 1978. Decontrol under Senate bill 1302 would reduce our concerns in this regard.

The decontrol measures calling for contract abrogation and authorizing these above-market prices also tend to place major producers and affiliated producers on a basis that is more or less favorable from a competitive advantage over small independents.

We, like some of the others that have already expressed their opinions, feel that any kind of a full, comprehensive decontrol bill must include a provision that provides small producers an antitrust exemption in order to cooperatively combine gas reserves for marketing. We also believe that the Fuel Use Act needs to be repealed and that the Natural Gas Policy Act needs to be revised so that the incremental pricing will be abolished.

We feel that while some others have mentioned about all of the exemptions that have been granted, we feel that they do aggravate an already weak demand picture and do place some pressure on already shut-in gas due to lack of a market.

Finally, I might say that we support the Senate bill 2285 provisions as it regards open access carriage. We feel that the administration's bill in this regard is superior to the others in that it allows the FERC to decide these matters and would avoid much of the statutory complexity on an issue that is not readily understood.

Summarizing, we support Senate bill 1302 to include the antitrust law exemption and the open access carriage provisions of 2285.

That concludes my statement.

[The prepared statement of Mr. Watson follows:]

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STATEMENT ON

Pending Legislative Proposals to Decontrol Natural Gas and Related Issues

SUBMITTED BY

John E. Watson, Chairman
FERC Regulation Task Force
Texas Independent Producers and Royalty Owners Association

Before the

Committee on Energy and Natural Resources
United States Senate

Washington, D.C.
May 20, 1986

Mr. Chairman and Members of the Committee:

My name is John E. Watson. I am a Senior Vice President of Mitchell Energy Corporation, The Woodlands, Texas. However, today I am appearing on behalf of the Texas Independent Producers and Royalty Owners Association, better known as "TIPRO". TIPRO is composed of some 4,500 independent producers and royalty owners, most of whom have interests in or are directly involved with the exploration and production of domestic natural gas.

We appreciate this opportunity to appear on the several natural gas issues treated in Senate bills 834, 1251 (as incorporated in 1302), 1302, 3205 and 2285. TIPRO has historically supported the decontrol of all gas supplies and is currently concerned as well with constraints on the producer relating to transportation access to gas markets and demand for his natural gas production. Therefore, the possibility of legislation dealing with these problems is of interest to us.

TIPRO supports the methodology for decontrolling controlled gas found in S. 1302, the amendments to the Fuel Use Act and the elimination of incremental pricing also found in S. 1302 and the initiation of open access carriage as presented in S. 2285. We restrict our brief comments to these issues.

Gas Decontrol

S. 1302 attacks the problem of decontrolling natural gas in a clean, relatively simplistic manner acceptable to most independent producers. In essence, the bill recognizes the sanctity of contract, upon which virtually all historic sales of natural gas have been based. Gas would be deregulated when governing contracts expire, lapse, terminate or are renegotiable under their own terms. There would be no contract abrogation involved and no confusion with former regulatory requirements such as are involved with area rate clauses.

This approach to deregulation is preferable to that proposed in S. 2285 and also to that proposed by the Department of Energy (DOE) before the Federal Energy Regulatory Commission five months ago. Both alternatives require contract abrogation in part to achieve the decontrol objective.

The DOE proposal raises other issues of concern to the small independent producer that must be recognized in any attempt to decontrol all natural gas. For example, DOE attempts to raise prices of controlled gas in a regulatory framework that creates price ceilings well above currently perceived market clearing levels. In today's soft gas market, does this mean additional lowering of prices for high cost incentive gas developed by independents under the NGPA and for new gas discovered by those same independents? We fear it does. Decontrol under S. 1302 would reduce such concerns significantly.

Decontrol measures calling for contract abrogation and authorizing above-market pricing also tend to place major producers and producers affiliated with purchasers at a competitive advantage over small independents.

S. 1302 eases this problem by avoiding abrogation and non-market pricing. Nevertheless, TIPRO, like IPAA, strongly urges that any final decontrol bill include a provision providing small producers an anti-trust exemption authorizing them to combine gas reserves for marketing purposes.

Elimination of Demand Constraints

One of the more crucial legislative needs confronting the independent gas producer and royalty owner is adjustment in the Fuel Use Act and the Natural Gas Policy Act to eliminate constraints on the market for domestic natural gas. Although the FUA provides exemption relief, it clearly discourages use of natural gas by utilities. NGPA incremental pricing provisions clearly discourage use by industrial customers.

These legislative measures aggravate an already weak demand picture for gas producers, many of whom are virtually shut-in due to lack of market. From 1982 through 1985, commercial and industrial annual demand for natural gas dropped at the annual rate of 1.37 trillion cubic feet. This amounted to approximately ten percent of total demand and an estimated 50 percent of excess producing capacity among the nation's gas producers.

Accordingly, TIPRO would welcome passage of S. 1302, which would correct the demand problems caused by the FUA and the NGPA. Producers need the increased opportunity to produce, if they are to remain in position to drill replacement wells for the future.

Open Access Carriage

Finally, TIPRO supports the open access carriage provision of S. 2285 as the appropriate method for establishing market access for all gas producers. It cleanly establishes the authority for FERC to proceed with development of a carriage system that works and is fair to all parties concerned. Such latitude for the agency will avoid much statutory complexity on an issue that is subject to change and is not readily understood.

For the above reasons, TIPRO would welcome passage of S. 1302 as amended to include an antitrust law exemption and the open access carriage provision of S. 2285. Thank you for this opportunity to appear.

Senator NICKLES. Mr. Watson, thank you very much again for your appearance before our committee.

For our next panelist we have Mr. Barry Snyder with AEON Energy, Lakewood, CO, and on behalf of the Independent Petroleum Association of the Mountain States.

Mr. Snyder.

STATEMENT OF BARRY L. SNYDER, ON BEHALF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES

Mr. SNYDER. Thank you.

I am an independent gas and oil producer representing the Independent Petroleum Association of the Mountain States today. IPAMS is a regional trade association representing 1,500 independent producers and associated companies in the 11-State Rocky Mountain region.

The independent producers in this region have been especially hard hit by the current slump in the natural gas industry. Exploration in the region is frequently conducted in frontier areas where much of the gas is from tight sand or deep formations. Therefore, higher than usual finding and producing costs are routinely incurred.

Further, Rocky Mountain natural gas producers have historically faced limited transportation and marketing opportunities due to the lack of a well developed pipeline network in the region. Only five interstate pipelines with the capability to move gas to markets outside the region are available to serve producers in the entire 11-State area.

There is little overlap in these systems and consequently little competition between them. The effect of this situation is apparent in a recent IPAA gas producers survey which indicates that Rocky Mountain producers are selling less than 40 percent of their deliverable supplies, while the national average is around 60. Entire producing basins are virtually shut in.

Coupled with the drastic decline in crude oil prices, the reduction in cash flow to independents in the region threatens their very existence. On a daily basis, newspapers carry stories of additional office closures and budget reductions. With each story, additional people are added to the list of unemployed.

The activity level has fallen to the modern day low of 66 active rigs. This was down from 5 years ago at 654.

Despite the present condition of the industry, IPAM's members are not seeking Government bailouts or subsidies. They simply ask an opportunity to compete on the so-called level playing field. In order to compete, these companies need access to transportation and markets. At the present time, access is usually available only on the condition that the gas will not compete in a particular market area or that it will serve to reduce take or pay liabilities of the pipeline. In other words, if it is available, it's on a discriminatory basis.

IPAMS calls on Congress to enact comprehensive natural gas legislation encompassing the following basic elements: Mandatory open access to all transportation systems. This is the most important and basic element for any natural gas legislation, since it is the very foundation of a competitive free market system.

Removal of remaining wellhead price controls. Total decontrol is the second most important element for a more competitive natural gas market. The time is perfect since there is virtually no possibility of a consumer price fly-up under the current energy oversupply conditions.

Repeal of the Fuel Use Act. Expansion of the natural gas market is limited by Federal regulations at a time when industrial use should be encouraged, since natural gas is an abundant, clean-burning energy source which will have a positive impact on the environment as opposed to most other forms of energy.

End regulatory bias favoring imports. IPAMS does not seek quotas or tariffs on natural gas imports. We simply seek the opportunity to compete on an equal basis with pipelines' marketing affiliates.

Natural gas royalties based on actual receipts. This is especially important in the Rocky Mountain region, where there is an abundance of Federal land, since it is rare for a producer to collect NGPA ceiling prices or even full contract prices in today's market. It is time for the Federal and State governments to adopt a royalty standard based on producers' net proceeds under an arm's length contract.

Last, cooperative marketing antitrust exemption. In order for independents to compete effectively for large industrial markets, an avenue for competitive cooperative marketing must be provided.

Congressional action is urgently needed to preserve the independent segment of the natural gas industry. The current lack of access to transportation and markets, coupled with irrational and discriminatory regulations on the use of natural gas, are distorting the natural gas marketing system of this country to the detriment of both producers and consumers.

[The prepared statement of Mr. Snyder follows:]

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TESTIMONY OF THE

INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES

Submitted to the

Senate Committee on Energy and Natural Resources

May 20, 1986

RE: COMPREHENSIVE NATURAL GAS LEGISLATION

David W Wilson
David W. Wilson
President

Barry Snyder
Barry L. Snyder
Natural Gas Committee

Ken Wonstolen
Kenneth A. Wonstolen
Executive Director

EXECUTIVE SUMMARY

IPAMS, the regional trade association representing 1500 independent producers and associated companies in the eleven Rocky Mountain States, calls on the Congress to enact comprehensive natural gas legislation encompassing the following basic elements:

- mandatory open access to pipeline transportation systems
- removal of remaining wellhead price controls
- elimination of natural gas demand constraints
- an end to regulatory bias favoring imports
- royalty assessments based on actual producer receipts
- antitrust exemption for independent producer marketing co-ops

Immediate action on this legislative agenda is urgently needed to preserve the independent segment of the domestic natural gas industry. The current lack of access to markets, coupled with irrational and discriminatory regulatory policies, is distorting the natural gas system of this country to the detriment of both producers and consumers.

BACKGROUND

Independent producers in the Rockies have been especially hard hit by the current slump in the natural gas market. Rockies producers frequently explore and drill for gas in frontier regions, incurring higher finding costs. Much of the region's gas is from deep or "tight-sand" horizons and is consequently more expensive to produce. Further, only five interstate pipelines (Colorado Interstate Gas, El Paso, Cities Service, Panhandle Eastern and Northwest Pipeline) are available to producers in the entire eleven-state IPAMS region.

The effect of this situation is apparent in a recent Independent Petroleum Association of America survey of independent gas producers which indicates that Rocky Mountain independents are selling less than 40% of their deliverable supplies, compared to a national average for independents of over 60%. Entire producing basins are virtually "shut-in". Coupled with the drastic decline in crude prices, the reduction in the cash flow to independents in the Rockies threatens their very existence.

IPAMS members are not seeking government "bail-outs". They simply seek an opportunity to compete on a "level playing-field", under a rational system of regulation, and with access to transportation and markets. If the Congress will unleash the free enterprise energies of the Rockies independents in this fashion, they will make an important contribution to future domestic energy security.

Following are the necessary components of comprehensive natural gas legislation.

OPEN ACCESS TO TRANSPORTATION AND MARKETS

This is the crucial element to natural gas reform. It is the foundation of a rational, competitive, free market. If pipelines are able to extend their exclusive powers over system-supply gas transportation into the competitive fuel market, through discriminatory transportation practices, both producers and consumers will suffer. Price decontrol and elimination of demand restraints would be virtually meaningless to most producers without open transportation.

Opponents of mandatory open access will no doubt point to Federal Energy Regulatory Commission Order 436 as the solution and urge that it be given time to work. IPAMS asserts that it is already apparent that Order 436 will not result in open access to transportation and a competitive natural gas market.

The Energy Information Administration, in "An Analysis of FERC Order 436" (RNGD-86-02) submitted to the House Committee on Energy and Commerce in April of this year, warns: "While the Order offers the potential of an efficient transition to new and more competitive market realities...it also offers new opportunities for the exercise of market power on the part of the pipelines....If (FERC) takes a non-generic approach to implementing Order 436, the result, instead of increased competition under an open transportation system, could be a long and tedious transition to... regulation that may be no better than the current system."

The EIA further cautions that "it is important that exceptions...not be granted that would allow Order 436 to become a tool for price discrimination by the pipelines" and that "some of the settlements submitted by pipelines...to FERC are proposing major deviations from Order 436...." The EIA concludes that "under Order 436, other transport programs under regular certificates can continue to exist and have already been granted, so the incentive to accept participation in the program is considerably reduced.

IPAMS would further assert that, even when pipelines have elected to participate in Order 436, it is being implemented in such a fashion as to perpetuate discriminatory transportation practices and to foreclose meaningful open access for producers and consumers. This is because FERC is relying on the "non-generic", private settlement process for allocation of transportation capacity and tariff determination. The pipelines are threatening to cut off open transportation (or not to offer it at all) unless their settlement conditions are met.

For example, El Paso Natural Gas has filed to become an Order 436 transporter. This was meaningless to most producers and third party marketers, however, because, prior to filing, El Paso managed to fill its available pipeline capacity to transport direct sales (competitive) gas. In part, this capacity will be used to import 400 MMcf per day of Canadian gas through its El Paso Gas Marketing affiliate. (At the same time, El Paso was warning domestic producers in New Mexico to expect a 400-500 MMcf per day reduction in system supply takes and requiring that producers renegotiate their contracts as a condition to being able to sell gas to the marketing affiliate.)

This situation is not unique, and FERC has contributed to the problem by twice extending the "grace period" for pipeline election into Order 436 transportation. Pipelines have been allowed to continue discriminatory (Section 311) transportation until July 1, 1986.

FERC has further eroded the stimulus to open access by issuing "blanket" traditional (Section 7C) transportation certificates which constitute an "end-run" around the goals of Order 436. The first instance was FERC's grant of a Section 7C transportation certificate to Texas Eastern to service 52 end-users previously being served under a discriminatory special-marketing program. Last week, FERC approved two more "blanket 7C's" over the dissent of one of the two remaining Commissioners involved in formulating Order 436. One of the new Commissioners has been quite explicit about his antipathy to the "theoretical" approach of Order 436 and his intent to "move gas" under a business-as-usual approach.

Never has a regulated industry, by threatening to withhold services except on its own terms, exercised such effective control over the responsible regulatory body. With the success that the pipelines have had in the implementation of 436 at FERC, it is easy to understand their decision to support only limited legislation.

Thus, it is clear that the results warned against by the EIA are already occurring. By extending the Order 436 grace period, pipelines have been given time to fill available transportation capacity with affiliate-owned and imported gas. FERC has allowed pipelines to convert discriminatory special marketing programs to traditional system-supply transportation. And, by relying on case-by-case, private settlements, pipelines have been allowed to allocate transportation capacity and establish transportation tariffs in a fashion which effectively excludes the at-large community of gas producers and consumers.

The only solution to this business-as-usual result of Order 436 is Congressionally-mandated open access for producers and consumers to pipeline transportation and distribution systems. This fact has been recognized by the Administration in its proposed "Natural Gas Policy Act Amendments of 1986." IPAMS urges the Congress to make open access the centerpiece of natural gas reform.

It should be noted, before leaving this issue, that the pipelines have consistently sought to couple open access with "take-or-pay" relief. There is no rational relationship between elimination of discriminatory pipeline transportation practices and federal abrogration of freely-negotiated, private contracts.

IPAMS asserts that pipelines have overstated the magnitude of the take-or-pay problem by claiming financial liabilities which exclude the possibility of eventually taking and selling the subject gas. Take-or-pay amounts paid to producers are credits against future production which can be made-up. In addition, much progress has been made in renegotiating and settling take-or-pay problems. Natural gas reform which opens up the transportation system, eliminates price distortions and removes demand constraints will only serve to stimulate contractual renegotiation as producers and pipelines seek to compete in the free-marketplace.

WELLHEAD PRICE DECONTROL

The other key element to natural gas reform is the elimination of remaining Natural Gas Policy Act wellhead price controls. The irrational disparities in wellhead gas prices based upon date of discovery, the unnecessary complexities in the "old gas" price vintaging system and the resultant distorted market pricing signals demand correction. And, decontrol will clearly not result in a consumer price "fly-up" under current energy oversupply conditions. The results of crude decontrol and the partial NGPA decontrol of most "new gas" on January 1, 1985, demonstrate that decontrol of all natural gas wellhead prices will lower consumer costs.

The Department of Energy has estimated that its proposal to FERC to eliminate old gas price vintaging and provide incentive prices for "production enhancement gas" would result in the additional recovery of 34 Tcf of existing gas reserves, with national economic benefits of $25 billion over the next decade. Total wellhead price decontrol is projected to result in a 15% average price drop in the first year.

IPAMS agrees with the Administration that price decontrol should generally occur within contractual parameters, with a date certain for final elimination. This will stimulate the renegotiation process. However, some interim provision may be needed where federally-dictated contractual clauses (e.g. "area rate" clauses) would distort the producer-purchaser relationship. Of course, the open access for direct sales option must be available to producers to provide bargaining leverage and a response to pipeline exercise of "market-out" clauses.

LIFTING NATURAL GAS DEMAND CONSTRAINTS

The end-use market for natural gas is federally-limited by restrictions of the (Powerplant and Industrial) Fuel Use Act and through the imposition of NGPA "incremental pricing", whereby utility/industrial users subsidize gas prices to the commercial and residential sectors. This price subsidy is often enlarged by state utility commissions which administer "lifeline" and other social-purpose rate structures.

The House has taken initial action to repeal the Fuel Use Act restraints on new utility/industrial gas utilization.

However, as a stand-alone measure, it is an empty gesture. Exemptions from the Fuel Use Act are routinely granted under the current Administration, and no significant, new gas-fired utility capacity is being contemplated by the overbuilt electric industry. Indeed, over the last five years, utility demand for gas for electrical generation has declined by 17% (from 3.6 Tcf in 1981 to 3.0 Tcf in 1985). This demand drop is because of higher delivered gas prices and in some cases, lack of available transportation to users.

Industrial gas demand has dropped by almost the same proportion (18%) over the same period (from 7.1 Tcf to 5.8 Tcf). However, representing 37% of total gas demand, the industrial sector offers the largest potential to increase near-term gas consumption. At current market-clearing price levels, natural gas can begin to recapture industrial load growth accompanying economic expansion. The burgeoning "cogeneration" market is a good example. Industrial users always unanimously state that the lack of transportation at reasonable rates is the biggest impediment to their increased demand.

Repeal of the Fuel Use Act would be an appropriate governmental signal to an industry once told that natural gas supplies were about to be exhausted. More important is an end to social-purpose price subsidies and a shift to true, cost-based rates. Most important, once again, is providing the industrial user with the option and security of direct, open access to natural gas supplies.

REGULATORY BIAS TOWARDS IMPORTS

IPAMS does not seek quotas, tariffs or other artificial restrictions on natural gas imports, primarily from Canada. IPAMS members are more than willing to compete for these markets. However, the Association does object to regulatory policies which actually skew the "playing-field" in favor of imported gas.

The first aspect of this bias is in preferential transportation. For example, the El Paso gas import application earlier discussed involves moving the gas via "third-party" transporters. In other words, imported gas, owned by a pipeline's marketing affiliate, will receive preferential transportation to markets closed to domestic producers. Open access is the answer to removing this barrier to competition.

The second aspect of regulatory bias arises via rate regulation. Often, imported gas is sold under a two-part rate structure incorporating both "demand" and "commodity" components. The demand charge represents a reservation fee, paid whether or not the gas is actually taken. Naturally, the gas consumer seeks to minimize the unit cost of the demand charge by maximizing the volume taken. And, since the cost is incurred if the gas is not taken, domestic producers must reduce their prices by the amount of the charge in order to displace imports. At today's price levels, the necessary domestic price reduction to compete may reach 50% from the "spot" price.

IPAMS urges the Congress to direct the Economic Regulatory Administration and FERC to eliminate these regulatory biases which distort the competitive playing field. IPAMS does not seek to restrict gas imports, but asserts the right to an equal competitive opportunity.

RECEIPTS-BASED GAS ROYALTIES

Since the enactment of the NGPA in 1978, federal gas royalties have been based (under "NTL-5") on the highest possible value -- NGPA ceiling price, highest field price or contract price -- regardless of the producer's actual receipts. This represents an unwarranted departure from our nation's free enterprise principles and fails to recognize the commonality of interest between the producer and royalty owner. After all, both benefit when the producer, by nature, seeks to maximize his sales revenues.

Today, it is rare for producers, especially independents, to collect NGPA ceiling prices, or even full contract prices. Pipelines have used "force majeure" or "market-out" contract clauses to unilaterally reduce takes and prices, or to simply walk away from contracts. Wellhead prices have dropped substantially.

Assessing federal royalties based on illusory values penalizes producers already strapped for cash flow. Approximately $150 million in back royalties and penalties have been assessed to the industry, most of which is being contested. However, while the appeals process grinds on, the producer must submit the contested amount or, if he can obtain one, post a bond.

The Minerals Management Service has begun a process to revise the federal royalty rates on two fronts. It is considering repeal or revision of NTL-5, while also engaged in an effort to develop comprehensive new guidelines. Initially, MMS has proposed reliance on "arms-length" contract prices, a standard IPAMS supports. However, MMS would assess such royalty even if the producer was unable to collect his contractual price, unless the producer initiated litigation against the purchaser. This is a "Hobson's choice" and an infeasible approach.

Further, MMS asserts a right to gross sales prices, ignoring costs the producer may have to bear to gather, process and transport the gas. It claims a right to take-or-pay amounts on gas remaining in the ground. And, it wants a share of the enhanced product value derived from manufacturing gas liquids. IPAMS asserts that the federal government, as royalty owner, should stand in no better position when it collects royalty based on product sales than it would if it received its royalty share "in-kind", at the wellhead.

Therefore, IPAMS urges Congress to direct MMS to adopt a royalty standard based on a producer's actual net receipts under an arms-length contract. In addition, relief from excess royalty liability imposed under NTL-5 should be granted retroactive to the enactment of the NGPA.

CO-OP MARKETING ANTITRUST

Pipelines have traditionally enjoyed monopoly power over gas transportation and system-supply sales. Energy oversupply and inter-fuel competition, along with court decisions and federal policy changes, are trying to move the natural gas system towards a more competitive posture. However, pipelines have responded by utilizing production/marketing affiliates to extend their system-supply domination into the new competitive arena.

In order for independents to have a meaningful opportunity to compete for direct gas sales, an avenue for co-operative marketing must be provided. Many smaller independents will lack the reserve size and marketing resources to effectively compete for large industrial load customers. Providing an antitrust exemption for independent producer marketing co-ops will allow independents to counterbalance the marketing power of the pipelines and the major oil companies. Such an exemption would enhance the competitive effects of open access and wellhead price decontrol.

Senator NICKLES. Mr. Snyder, thank you very much.

To all of our panelists, I thank you. I have questions. Ms. Wischer, I will start with you. You mentioned the same thing that Mr. Snyder just did, and either of you could answer it.

You mentioned this question of Federal royalties being paid on or mandated by the Government in excess, I am assuming, of what the actual paid price is. Is that correct?

Ms. WISCHER. No, that is not correct.

We are advocating the payment of royalties on the amount received by the producer.

Senator NICKLES. OK. I understand. But so what you are saying is that the Government is mandating that royalties be paid on a price in excess of what a producer is paid?

Ms. WISCHER. Unless they are mandated NGPA ceiling prices.

Senator NICKLES. Can you give me an example, Mr. Snyder?

Mr. SNYDER. Yes. What they are doing today is asking that royalties be paid either on one of three bases, really. One is the Natural Gas Policy Act ceiling price, which nobody is receiving any more, or virtually no one any more.

Senator NICKLES. Are you talking about 102?

Mr. SNYDER. Or 107 is a prime example in the Rocky Mountain area, where we have a considerable amount of tight formation gas. Our NGPA ceiling prices on that stuff are probably $6.50. Right now I am currently receiving $1.66. Fortunately, I am not on Federal land with it.

Senator NICKLES. Let me just follow that up. Are there some examples where the Government is charging a royalty based on that 107 tight sand gas price, even though the actual market price is substantially less? That is what I am trying to——

Mr. SNYDER. Oh, very definitely.

Senator NICKLES. Would you provide some examples for us for the record. We will work on that. We will get it cleaned up, either administratively or—and we will also submit a question to the Secretary, to see if we cannot solve that administratively, so you do not even have to wait for the legislation.

If not, we will include that in the legislative remedy as well. At least we will try to.

Mr. SNYDER. There is a considerable amount of work being done by the MMS along these lines, but it really has not solved anything at this point.

Senator NICKLES. They are still charging—the net effect of it is that they are still charging royalties not on actual transaction price, but they are charging it on—I know we had a case with MMS on OCS where royalties were based on the highest price in a region. We have some of that even in our State of Oklahoma in Osage County, I think, where they are trying to get royalties based on the highest dollar price in a particular area or something, not so much on NGPA price.

Mr. SNYDER. OK. There is the two, one of which you mentioned, one of which I mentioned. And the third one is they are actually trying to in some cases hang you with a contract price that you can no longer collect.

Senator NICKLES. So if you are not able to get the contract price——

Mr. SNYDER. Yes.

Senator NICKLES. Well, give us some examples if you could. And Ms. Wischer as well, maybe if you could work with the association to provide the committee with some actual examples where royalty—or where the Government is requesting royalties of amounts in excess of the transaction price.

I think that would be helpful for clarifying it.

Also, several of our panelists mentioned—and Ms. Wischer, I will turn this one back to you as well—the request or hope for an antitrust exemption for independents working in a cooperative manner. Would you explain that a little bit further?

Ms. WISCHER. Well, it is so that we can form cooperatives to help us market gas and find end-users.

Senator NICKLES. Primarily just to market gas, or is it to market oil and gas?

Ms. WISCHER. Well, of course I am dealing primarily in gas.

Senator NICKLES. And so independents would go together, pool their gas as such, so they would be able to possibly provide a potential either-end-user or pipeline or something a greater volume?

Ms. WISCHER. In certain areas, yes.

Senator NICKLES. And right now they do not have an antitrust exemption?

Ms. WISCHER. No, we do not.

Senator NICKLES. Have you been successful in operating without an antitrust exemption? Is one necessary? Is it being contested in courts? What is the requirement that an antitrust exemption be granted now? Anyone? Mr. Gentry, you mentioned it as well in your statement.

Mr. GENTRY. Senator Nickles, any time there is a meeting of independent producers, whether related to an association meeting or otherwise, any time the question of price comes up people leave the room, jump out the windows, get out of there any way they can, because the folklore is that this is a violation of antitrust law.

Whether it really is or not, I do not believe there has been a test case. But there are very few people willing to take the chance that it would be held to be a violation of antitrust law for a group of producers to get together simply to put together a large enough package of gas to interest a buyer at a distance, and that is the problem.

Most of the smaller producers do not have sufficient gas reserves or deliverability to interest a buyer at a distance is a substantial enough deal to justify the expense of the cost of trying to make those arrangements. The lack of a specific clarification in the law or an exemption, if it takes it, that there are no antitrust problems with that kind of an arrangement is an inhibiting factor which should be removed.

And it is of no cost to anyone. If the resulting package that they put together is too high priced for people to buy, they will not buy it.

Senator NICKLES. I appreciate your comment. I remember the issue coming up kind of late in the game when we worked on the previous bill, and it was included. If I remember, Senator Domenici and Senator Wallop and others brought it up, and it was included and it was not really a controversial issue.

But I would be interested again if there was some information from OPAA or whoever, who might give us some more background for the need for that clarification of court cases or whatever that might help us, give us some background to include that in our markup that hopefully we will be working on pretty quickly.

A couple of other things. I heard, I think, most of our panelists—correct me if I am wrong—say that, out of the three major elements that we are looking at in the proposal, access being of primary importance. Does anybody disagree with that?

Mr. HARGROVE. The whole package is important.

Senator NICKLES. Do all of you agree that maybe a comprehensive package is more important than just the Fuel Use repeal?

Ms. WISCHER. By all means.

Senator NICKLES. Does anybody disagree on the order of importance? You mentioned access, No. 1. Is decontrol more important than the elimination of end-use restraints? Mr. House.

Mr. HOUSE. I think the OIPA concurns that transportation is the most important thing, and we put the decontrol and the Fuel Use pretty much as a tossup. Both of them would be something we would be very interested in. We think the comprehensive legislation is important, but we also are realists and will take whatever we can get.

Senator NICKLES. Let me ask another question on somewhat the same line. Mr. Watson brought it up and as the first panelist—as a matter of fact, all of our panelists I think supported decontrol. Mr. Watson mentioned one comment concerning decontrol and the possibility of, I guess I am going to say, from the DOE proposal, the vintaging proposal, that would allow some increases under 104, and the fact that—you did not use the word "majors"; I will use it—the fact that the majors own a greater percentage of old gas.

That might put—if those prices do have some increases—that might put more downward pressure on the newer categories of gas, your 102's and 103's, more downward pressure on that.

Anyone else share that concern? Mr. House.

Mr. HOUSE. I think that I agree with Mr. Watson's comments, that that is a concern of the OIPA, that downward pressure will occur. Most of our contracts today have in some shape, form, or fashion been ignored by the pipelines, and as a result of that being ignored we have entered into negotiations as to price, as to takes, as to connection requirements, tax reimbursement, you know, a host of issues.

And anything that puts additional pressure on independents is something that we would be very concerned about.

Senator NICKLES. Mr. Hargrove.

Mr. HARGROVE. Mr. Chairman, in response to that and the setting of priorities, we are talking about apples and oranges in one respect. On a short-term basis, access may be the most important thing. On the long-term basis, deregulation is.

Immediately, there is no question about it, it is the majors that have the 104 gas and we do not. But when this thing turns around—and it will—why, we want to be in a free market. We have never had one. That is what we need. That is the way the system is supposed to be.

Short range, it will hurt us. Long range, it will help us.

Senator **Nickles**. Mr. Gentry, you wanted to add something to that?

Mr. **Gentry**. Yes, sir. The independents in New Mexico identify with the remarks that Mr. Watson made, and there is some degree of concern about the manner in which decontrol is effected. Certainly independents would like to have the effect on the gas which they have the most available in their inventory base to be least affected.

But as the gentleman who just spoke mentioned, when we come out of this thing on the other end we would like to come out with a totally free market and without the restraints of wellhead price controls in any fashion. And there has got to be something given up to get that, and we have come to the point that where, absent abrogation of contracts to the extent that we just cannot support, that the independents of New Mexico are supporting decontrol.

Senator **Nickles**. Mr. Gentry, I appreciate your comment. Let me just make kind of an editorial comment. In the bill which I have introduced, 1302 on old gas, you know, everybody—there are several different bills that float around saying, these are decontrol bills, and they have little different approaches.

Mr. Watson recognized that in his statement. Under our approach, under the bill that I have introduced, it would decontrol as those contracts expired or as they're renegotiated. And what percentage of those contracts would be renegotiated is anybody's guess. What percentage would expire on a year-by-year basis could probably be determined, and it would probably be a small percent of those contracts. So it would have de minimis impact in my opinion on the other contracts.

We have also heard some of the pipeline representatives today mention that they could live with that type.

The administration's bill, which just basically says all categories of regulation would cease April 1987, that is another approach. That has some very good things. It may hurt Mr. Snyder, where you have some categories of high-cost contracts that would still be regulated for some time. So I mean, there may be again some winners and losers, but also some of those contracts are outside of the marketplace.

So I mean, there are certain advantages of having a statement that says, yes, at such and such date there will be no price controls. So we are going to be looking and wrestling with that.

I wanted to make sure that—I heard everybody say they wanted decontrol. I wanted you to know that there is a couple of different ways to skin that cat that we are looking at.

One final question—Mr. Snyder.

Mr. **Snyder**. I might just mention that as long as—you know, downward pressure on gas prices is a possibility under decontrol. But quite frankly, right now what we have got is pipelines through marketing affiliates who have access to this supply of old gas, who can undercut your price right not anyway.

As long as we have controlled gas prices, we are never going to have a true market, because you have got them being able to utilize the low-cost gas in order to undercut your so-called market price on the freely trading gas anyway. So I think it is kind of six of one and half a dozen of the other when it comes to downward pressure on the gas.

Senator **Nickles**. Well, just again I will make another editorial comment. There is downward pressure being exerted on gas, period. Now, one can argue, and I would say that, yes, if we have a deregulation bill that may even exert more downward pressure.

But it also provides us with an opportunity for the first time in 30-some years to get out of this regulated scheme, which this battle has been before the House and the Senate for all of these years. Now is the time. I do not know how we could have a more opportune time to move.

There is going to be pain felt in the industry, but that pain is already there. Mr. Graves, you mentioned that you have 1,500 members. Is that still close to correct?

Mr. **Graves**. Yes, sir. At our last count we were right at 1,500 members. 1,500 struggling members, I might add.

And also, just the very existence of FERC itself is a downward pressure on the price of natural gas, I will assure you that.

Senator **Nickles**. I do not doubt that.

I made comment to the Secretary earlier of the fact that we went to 757 active rigs, which is lower than any time since World War II. This industry is hurting right now.

Now, I do think—again we are dealing primarily on natural gas. I do think that there is a very good future for the natural gas industry. I do not see domestic oil production increasing in the lower 48 any time. We were just holding even with 3,000 to 4,000 rigs running. Now we are running with 757 rigs. That is going to decline.

I do see increases in the natural gas industry. I see increased potential growth, expansion, employment, activity in this industry. And I think it behooves us to take advantage of this market cycle that we are in right now to deregulate and allow the marketplace to operate.

A final question on access. Again, everybody put that high on their priorities. We heard Mr. Bailey and some other people talk about, under the administration bill it says "without discrimination." He said it would be a better standard to use "without undue discrimination."

Does anyone have any comments on that?

Mr. **Hargrove**. How do you define it?

Senator **Nickles**. I ask the questions. [Laughter.]

That is one of the nice things sitting on this side of the table. I am going to do a lot of work between now and our markup between the definitions of "undue discrimination" and "without discrimination."

Yes.

Mr. **Snyder**. I think the word "undue" weaken it. It just leaves the door open for court case after court case about what "undue" is. I do not think you can define it. I think it personally weaken it to the point of—actually, if 436 could be totally enforced the way it is intended, it is not bad. But we are not getting that.

So there is no reason to think that by inserting the word "undue" that they are not going to take advantage of that also. I just think it weakens it.

Senator NICKLES. Mr. House, anybody else?

Mr. HOUSE. I think it is obvious we have been here for 8 months now trying to get 436 out, and we are not moving any gas under 436. We are closer to July 1.

But I think anything that gives the regulatory authorities and the pipelines more discretion among who they haul and for who they do not haul, et cetera, is going to hurt independents.

Senator NICKLES. Mr. Watson, were you going to add something?

Mr. WATSON. Well, I wanted to comment about something else if I could, when you are finished with this.

Senator NICKLES. Before you do that, I am trying to put together some elements for a bill that we can pass through this committee and get to the floor of the Senate. And we are looking at a variety of ideas that are not all that far apart.

Some people continue to come back and say, well, we cannot do anything in carriage. I for one have made mention, I do not want a 46-page carriage provision, and I think we had something at least that long the last time. And I really do not want to be in the business of having Senators out trying to measure capacity on pipelines, you know. And that is kind of what we were getting into last time.

So if we can come up with a carriage provision that makes sense and is understandable, and whether the term of art is "without discrimination" or "without undue discrimination," or we are looking at some other possible carriage provisions—so I would just make this comment to this panel and to the previous panel and other interested persons. I would appreciate your contacting us with your suggestions, because that is going to be one of the areas that we are going to be looking at in amending, at least in my opinion, probably amending the bill that I have before the Senate.

Mr. Watson.

Mr. WATSON. This is the reason that we have supported the administration's version of carriage, is because it pretty well turns it over to the FERC to decide, and we feel like with minimum statutory language they can do it. They have had some experience in this area and we feel that this is the best way to do.

I would like to comment, if I may, on something that Mr. Gentry mentioned with respect to imported natural gas and natural gas products. We at TIPRO also feel that, while we recognize that in times of shortage and what have you that we need to have a very good working relationship with both our friends, to the north Canada and to the south Mexico, but we also view with alarm the many, many import applications that are being filed with the ERA almost on a weekly basis for imports, at a time when the domestic producers, especially the independents, have a lot of gas cut back and shut in.

And we just do not see that that is the appropriate way to go, and we feel that the ERA and the FERC and the Congress should be looking at those matters. And we do not believe that barriers ought to be knocked down. We think the barriers ought to be put up to make sure that none of it is coming in on a discriminatory basis.

Senator NICKLES. Mr. Watson, let me ask you just a couple of questions. As you might have heard from my earlier comments, I have a concern about the amount that is imported, particularly when I see it imported at prices considerably above what we pay our domestic producers.

Are we importing Mexican gas right now?

Mr. WATSON. It is my understanding that we may be importing very small amounts.

Senator NICKLES. I am asking the wrong fellow.

Mr. WATSON. I do not know the volume. I think there is some gas coming in, a small amount of gas.

Senator NICKLES. We will obtain that for the record, both in Mexican and in Canadian gas.

Mr. HARGROVE. Mr. Chairman, there was at one time significant importation from Mexico, and those facilities are still in place. So they have the capability of introducing into our systems large quantities of gas overnight.

Senator NICKLES. We were buying—my memory is being stretched, but a couple years ago we were buying both Mexican and Canadian gas at $4.40. Then the Canadian regulators brought it down a dollar for marginal, incremental increases. Then they brought it down another step.

I should have asked some of those questions of the Secretary. We will get that information.

Mr. HARGROVE. That is the Canadian gas. At the conference which you attended in New Orleans that was sponsored by NIPRO, the Chairman of the Energy Board of Canada spoke at lunch and sat next to me. And his stated policy was that at the present time they were supplying approximately 8 percent of the U.S. market for natural gas and that their top target was 12 percent, and that they could not exceed that, if that is any help.

Senator NICKLES. Well, we will get that information. But again, it goes back to that comment, that I think that Canadian gas is just as old as our lower 48 gas, and it kind of seems imprudent in any type of policy to pay three, four, five times as much for imports as you are paying for domestic producers.

You are benefiting that government. You are having a negative balance of trade. You are hurting an industry that is in bad shape already.

Deregulation—again, I would, Mr. Watson, I would take a little different aspect. I do not think that quotas or import restrictions or limitations would really be the answer. I just really think the answer is to deregulate on our side and that should solve our problem.

Mr. WATSON. When I said a barrier to put up, I did not mean a quota system. I would not advocate a quota system. But I would say that it is one thing for us to be importing from, say, Canada 8 to 12 percent of our need at a time when we have a gas shortage; it is another to be importing 8 to 12 percent of our needs when we have got domestic producers and domestic production shut in.

Senator NICKLES. I need to conclude the hearing. Secretary Shultz is meeting with a bunch of us right now.

I do not know if IPAA or NGSA or whoever, if you have some information on the number of wells that are shut in of independent producers of gas. It would be very informative for this committee to have that.

I will ask any of you or your associations if you could give us the quantities of gas that are already on stream and that have been restricted or shut in. And I know that we have a tremendous amount in Oklahoma. Again, that is one of the comments I made. The natural gas industry has a tremendous potential for increased production and expansion, and we could do a lot more in our State and I am sure that we could in Oklahoma.

Or the amount of reduced takes; that would help. So if you have that information, I would appreciate it if you'd supply that for the record as well.

I need to conclude the hearing. Do you have a final?

Mr. SNYDER. One last comment on imports. I think the real key there is that no pipeline ought to be allowed to import if they will not transport for a domestic producer. I mean, we cannot even compete in the Rocky Mountain areas because they will not transport our gas. I do not care whether the Canadian gas is coming in or not. I will compete if we can get to a market.

But where you cannot even compete, that is the point where it no longer is fun.

Senator NICKLES. Interesting point.

To all of our panelists, I appreciate very much your patience and your participation in today's hearing. We will keep the record open for another 2 weeks for you to answer questions from myself or other members of the committee.

We will adjourn the hearing.

[Whereupon, at 12:38 p.m., the hearing was adjourned.]

[Subsequent to the hearing the committee received the following:]

Independent Petroleum Association of Mountain States
1214 DENVER CLUB BLDG. • DENVER, COLORADO 80202-4167 • [illegible]

July 1, 1986

Senator Don Nickles
Energy & Natural Resources Committee
Hart Senate Office Building Rm 713
Washington, D. C. 20510

Dear Senator Nickles:

On May 20, 1986, I presented testimony before the Energy & Natural Resources Committee regarding comprehensive natural gas legislation on behalf of the Independent Petroleum Association of Mountain States. During the course of those hearings, you asked me to provide the Committee with facts and figures relating to royalty valuation problems on Federal leases. To that end, we have pulled together information provided us by several different companies who are currently experiencing serious problems with MMS royalty disputes. They are enclosed along with a cover memo which summarizes them for you.

Additionally, IPAMS has contracted with the University of Denver to conduct a survey of oil and gas independents in the Rocky Mountain eleven-state region. This survey will question independents about the pipelines serving them in the region, their contracts, deliverability, and prices, and will provide us with current, accurate data which is not available elsewhere. The results will be forwarded to you and Senate Committee members as soon as the study is completed.

Senator Nickles, I take this opportunity to thank you for the interest you have shown by requesting this information, and we are prepared to provide you and your colleagues with supporting data as you wish.

Please do not hesitate to call on me or the IPAMS staff.

Sincerely,

Barry L. Snyder

Barry L. Snyder
Natural Gas Committee Chairman

BS/pag
cc: Members of the Senate Committee
on Energy and Natural Resources
(w/enclosures)

Independent Petroleum Association of Mountain States
1214 DENVER CLUB BLDG. • DENVER, COLORADO 80202-4187 • (303)623-0987

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• Executive Committee

MEMORANDUM

TO: Senate Energy Committee
DATE: July 1, 1986
FROM: IPAMS
SUBJECT: Examples of Royalty Disputes

Enclosed are materials relating to four different federal royalty disputes:

1. Matter of Lone Star Production
   - Royalty claimed on NGPA ceiling price of $3.70/Mcf where producer contract price was $1.55/Mcf. Government position would result in royalty burden of 29.8% of actual receipts.
2. Matter of J. C. Thompson
   - Dispute over proper categorization of production under NGPA. Government claiming royalty on price greater than maximum lawful price producer could obtain.
3. Matter of Home Petroleum
   - Royalty claimed on "BTU" value of "wet" gas at lease. Producer could only market this "casinghead" gas to gas processor under netback arrangement (share of value of gas liquids and residue gas).
4. Matter of Apache, et al
   - Royalty claimed on 100% of value of flared gas. Producers flaring gas pursuant to state conservation commission approval in conjunction with oil production.

LONE MOUNTAIN PRODUCTION COMPANY
P.O. Box 3394
408 Petroleum Building
Billings, Montana 59103-3394
(406) 245-5077

June 16, 1986

CERTIFIED MAIL:
RETURN RECEIPT REQUESTED

Minerals Management Service
Attn: Mr. William H. Feldmiller
Chief, Royalty Valuation and
Standards Division
P.O. Box 25165, Mail Stop 653
Denver, CO 80225

Re: MMS-RVS-OG:86-0198
Federal Oil & Gas Royalty
Determination; Gas Purchase
Contract, Southwest Gas
Corporation-Lone Mountain
Production Company; Federal
No. 5-3 and Federal No. 18-4
Wells, Grand County, Utah
and Garfield County, Colorado.

Dear Mr. Feldmiller:

Reference is made to your letter of May 20, 1986 regarding the non-approval by the Minerals Management Service of the above captioned Gas Purchase Contract. Please be advised that Lone Mountain Production Company wishes to appeal this decision in accordance with 30 C.F.R. 290. The reasons for this appeal are as follows:

The current market price being offered Lone Mountain Production Company by Southwest Gas Company is $1.55 per MCF. Based on this price, the Federal 12.5% royalty is 19.375 cents per MCF. The current NGPA maximum lawful price for this category of gas [103 (b)(2)] is $3.70 per MCF. Based on this price, the Federal Royalty would be 46.25 cents. This artificially high royalty amount effectively changes our federal royalty from 12.5% of 8/8ths to 29.84% of 8/8ths. This arbitrary and capricious royalty demand by the MMS flies in the face of all reason and past interpretation of oil and gas royalty determination.

Lone Mountain Production Company would most graciously accept a gas price of $3.70 per MCF from the area gas purchaser if this price was offered. Unfortunately, there is a present surplus of natural gas in this country and due to the recent collapse within our industry, $1.55 is the best price being offered to Lone Mountain for our product. Since the discovery of oil by Colonel Drake in 1865, the interpretation of a 12.5% "royalty" is that percentage of the market value of the product received by the operator from the purchaser based upon an arms length contract. Reason dictates that the current market must be the determining factor in the determination of any royalty, be it oil or gas. According to the terms of our federal oil and gas lease, the government is free to take its royalty share in kind and sell to a third party. I can assure you, however, that the price we receive is competitive with any purchaser in this gas producing province.

It seems incomprehensible that at this time, when small independent oil and gas companies are fighting for their very survival, the federal government would establish such a ridiculous ruling on this matter. Hopefully, some reason shall prevail, so that the independent oil company and the federal government can work again in partnership as we have for the past 100 years.

Very truly yours,

LONE MOUNTAIN PRODUCTION COMPANY

Thomas M. Hauptman
President

cc: Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091

The Honorable Donald Hodel
Secretary of the Interior

Ms. Pam Gerdeman
Independent Petroleum
Association of Mountain
States

Cy Jamison
House Interior Committee
1329 Longworth HOB
Washington, D.C. 20515

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File Copy

October 10, 1984

Corr w/ MMS
Stark #1

Mr. Norman J. Hess
Chief, Division of Appeals
Office of Program Review
LMS-Mail Stop 623
Minerals Management Service
United States Department of the Interior
Reston, Virginia 22091

Re: Docket No. MMS-84-0016-O&G
J. C. Thompson
Federal Lease No. 69-024551
Kiowa County, Colorado

Dear Mr. Hess:

I. INTRODUCTION

On behalf of Mr. Thompson, we would like to thank you for this opportunity to reply to Mr. Panella's Memorandum to the Division of Appeals, Office of Program Review. Your letter of July 3, 1984, gave Mr. Thompson "...30 days from your receipt of this letter..." in which to file a reply. Your letter was received by this office on July 10, 1984. You have agreed to a continuance until October 12, 1984, for the filing of this Reply. This Reply represents Mr. Thompson's appeal pursuant to 30 C.F.R. 290.2.

Because many of the references in both Mr. Panella's Memorandum and this Reply refer to arguments made in Mr. Thompson's December 30, 1983, Appeal (Thompson's Appeal), Thompson's Appeal is atached hereto and incorporated by reference. Thompson's Appeal also had several documents which were attached to it and they will be referred to in this reply. Thompson's Appeal sets forth Mr. Thompson's basic position and, therefore, we have chosen to not repeat the arguments therein. However, we do suggest that the reader start with Thompson's Appeal to get the basic factual background and the arguments. This Reply is more in the nature of a supplemental brief to address those arguments that were introduced to the case in Mr. Panella's Memorandum. We do want to point out now that certain of the arguments made in the gathering section as to gathering allowances after June 1, 1981, of Thompson's Appeal are modified or changed by this Reply.

We have always believed that there is some basic misunderstanding in this case. However, until Mr. Panella's Memorandum, we have been unable to precisely determine what was the nature of the misunderstanding. After reading the Memorandum, it is clear that there is a very basic misunderstanding on Mr. Panella's part as to the nature and the working of the Natural Gas Policy Act of 1978 (NGPA). It is for this reason that this Reply will be limited to those issues. We still believe that our arguments in Thompson's Appeal are valid and should be considered as part of this Reply.

It is obvious from Mr. Panella's Memorandum that something must be said on a more basic level about the NGPA. For purposes of clarity, we will follow Mr. Panella's outline in discussing these issues.

II. MMS'S POSITION

A. 221.47 Argument

Mr. Panella's arguments in this section are that the Secretary, by regulation, is permitted to determine "reasonable value" for royalty purposes. 30 C.F.R. 221.47. Mr. Panella argues that Mr. Thompson should pay royalty on Section 103 prices from February 1, 1979, forward because the Secretary has broad discretion in making these decisions and such a discretion will be disturbed by the Courts only if the Secretary is "...guilty of fraud, dishonesty or bad faith, or that the exercise of judgment was capricious or so unreasonable as to be incapable of justification on any rational basis." United States v. General Petroleum Corporation, 73 F.Supp. 225, 253 (S.D. Calif. 1947). Mr. Panella concluded that the Stark Well qualified for Section 103 pricing on February 1, 1979, based upon the following premises:

1. The Stark Well qualified as a Section 103 well effective February 28, 1979.
2. Any well that qualifies as a Section 103 well can receive Section 103 pricing.
3. "NGPA prices are regulated posted prices and, as such, can be used to determine value for royalty purposes." (p. 5 of Panella Memorandum)

First of all, February 1, 1979, is 27 days prior to the qualification of the Stark Well as a Section 103 well. In addition, of the three statements above, only the first statement is correct. It is not true that on February 1, 1979, that any well that qualified for Section 103 prices could collect Section 103 prices. The two obvious exceptions were Sections 104 and 105. Section 104 applies to "natural gas committed or dedicated to interstate commerce on the day before the date of enactment of this act (November 8, 1978) and for which a just and reasonable rate under the Natural Gas Act was in effect...." Section 105 applies to "any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing contract, which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act." (Emphasis added.) Simply put, Section 104 applies to gas being sold under an interstate contract on November 9, 1978, and Section 105 applies to gas being sold in intrastate commerce under a contract on the same date. It was the practice to dedicate or commit blocks of land and undrilled reserves to intrastate and interstate commerce. A well could qualify for Section 103 pricing because of when it was drilled and still be Section 104 or 105 gas because of its prior dedication under a contract. On February 1, 1979, a Section 103 qualified well that came under a Section 104 or 105 contract could not get Section 103 pricing.

The first Thompson contract (hereinafter called the "May 1 Contract") on the Stark Well, which is Exhibit C of Thompson's Appeal, is a Section 105 intrastate contract. The maximum legal price that Thompson could collect under this section is the **lower** of --

> (A) the price under the terms of the existing contract, to which such natural gas was subject on the date of the enactment of this Act, as such contract was in effect on such date;
>
> (B) the maximum lawful price, per million Btu's computed for such month under section 102 (relating to new natural gas).

Mr. Panella does concede that as long as the May 1 Contract was in effect Mr. Thompson could not collect the Section 103 price and would be limited to the contract price. (See: p. 8, second paragraph of Panella Memorandum.) Mr. Panella is correct in this position, but he goes on to argue that Mr. Thompson could have terminated this contract and automatically been eligible for Section 103 pricing. This is not true.

If Mr. Thompson had terminated the May 1 Contract all that would have happened would have been that he would not have had a contract and no gas would have been sold. If Peoples would have agreed to negotiate a new contract, which it wouldn't at the time, then the highest price that Mr. Thompson could have gotten would have been the Section 106(b) price, not the Section 103 price. Section 106(b) of the NGPA applies to any "...any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on the day before the date of the enactment of this Act...." A "rollover contract" is defined in Section 2(12) as:

> (12) **Rollover Contract** - The term "rollover contract" means any contract, entered into on or after the date of the enactment of this Act, for the first sale of natural gas that was previously subject to an existing contract which expired at the end of a fixed term (not including any extension thereof taking effect on or after such date of enactment) specified by the provisions of such existing contract, as such contract was in effect on the date of the enactment of this Act, whether or not there is an identity of parties or terms with those of such existing contract.

The FERC discussed the Section 106(b) rollover contract concept in Order 68 [45 Fed. Reg. 567 (January 24, 1980), FPAS Paragraph 105:315]. Clearly, had Mr. Thompson terminated the May 1 Contract he would not have then been able to claim Section 103 pricing, as Mr. Panella believes, but rather would have been able to only claim Section 106(b) prices which are the higher of the maximum price paid under the expiring contract (May 1 Contract) multiplied by an inflation facter determined by the FERC or $1.00 per MBtu multiplied by the same factor. The net effect on the price of natural gas sold of a cancellation of the May 1 Contract by Mr. Thompson would have been no increase in price because of Section 106(b).

Mr. Panella misinterprets People's letter of February 25, 1980, (Exhibit G to Thompson's Appeal) by suggesting that maybe Peoples was not aware that the Stark Well qualified as a Section 103 well. Read carefully, the letter states that Peoples was not willing to enter into a rollover contract because the May 1 Contract might not have terminated on a day certain because of the evergreen provision and that even if it was a rollover contract there would be no effect on price. (The evergreen question as to whether it was a rollover contract was later clarified in Order 68.) If a successor contract was entered into it would still be subject to the limitations of Section 105. The letter, in effect, says that there is no purpose of entering into negotiations that are not going to have any effect on the price. Peoples was aware that any well that qualified as a Section 103 and Section 105 well could not get Section 103 pricing. Contrary to Mr. Panella's beliefs, Mr. Thompson and Peoples could not enter into a new contract that permitted Section 103 pricing. It was not until much later that the FERC permitted them to amend their contract, which is more fully explained in Mr. Thompson's Appeal.

Mr. Panella also implies that, through some magic, Mr. Thompson had some power to force Peoples to renegotiate. Renegotiation is, and always has been, voluntary. Peoples and Planet had a lawsuit over that issue. (See: Thompson's Appeal.)

The ruling of Hoover & Broker Energies, Inc., 52 IBLA 27 (1981) and Wheless Drilling Co., 13 IBLA 21 (1973) is that price for royalty purposes cannot exceeds the Federal Power Commission (FPC), FERC's predecessor, maximum legal price unless the gross proceeds received by the producer exceed that price and that is not the case here. Mr. Panella seeks a price in excess of the maximum legal price. Mr. Panella's position is contrary to the Hoover and Wheless cases.

The next of Mr. Panella's premises is that NGPA prices are "regulated posted prices." They are not. NGPA prices are ceiling or maximum legal prices; they are not "regulated posted prices" as Mr. Panella contends. In support of his contention that NGPA prices are "regulated posted prices", Mr. Panella quotes Order No. 23 [44 Fed. Reg. 16895 (March 20, 1979), FPAS Paragraph 901:312]. Mr. Panella's argument is that since Order No. 23 finds that the lawful ceiling prices found in the NGPA are "just and reasonable" and since the Secretary has the right to set "reasonable" prices under 30 C.F.R. 221.47, therefore, the NGPA prices must be reasonable for royalty purposes. The term "reasonable" as used in 30 C.F.R. 221.47 and the term "reasonable" as that term is used in the phrase "just and reasonable" have two entirely different meanings.

First of all, NGPA prices are not "posted prices." Posted prices, as that term is used in the oil industry, refers to a crude oil price circulated in a field stating the price that a willing buyer will purchase from a willing seller. (See: 8 Williams and Myers, Manual of Terms.) Natural gas prices are not normally posted. However, used in the context of Mr. Panella's argument, he appears to mean a legislated market price. The history of the NGPA and the rulings of the NGPA are clear that NGPA prices are not legislated market prices. They are ceiling or maximum legal prices, not market prices. The Congressional history of the NGPA states and the FERC regulatory history clearly state this fact.

> The rule for application of ceiling prices pertains to maximum lawful prices. All maximum lawful prices are ceiling prices only. In no case may a seller receive a higher price than his contract permits. House Conference Report No. 95-1752, p. 74, 7 U.S. Code Cong. and Admin. News, 95th Congress, 1978, p. 8991.

> Both the terms of the new statute and its legislative history demonstrate that the prices prescribed in Title I of the Natural Gas Policy Act are *ceiling* prices. Contractual provisions governing the purchase and sale of natural gas are superseded or nullified only to the extent that the contractual terms would provide for prices *in excess* of the statutory ceilings. Contractual terms which provide prices below the statutory ceilings are unaffected. Order 23, *supra*.

Thus, it is clear that NGPA prices are not legislated or mandated market prices. Mr. Panella's position is contrary to that Congressional intent. Congress intended that market forces would be at work within the confines of the maximum legal price. It may be that at any given time the market price and the NGPA prices may be less, the same, or, in fact, greater than the market price, as it was in pre-NGPA days when the market price exceeded the regulated FPC price, but market price is not NGPA price.

The term "reasonable" as that term is used in 30 C.F.R. Section 211.47 does not have the same meaning as "reasonable" when used in the term "just and reasonable" as that term is used in FERC Order 23. The value of natural gas under 30 C.F.R. 221.47 is a reasonable value test or highest market value test. Reasonable value is defined as the "...value computed on the basis of the highest price per...thousand cubic feet...offered at the time of production in a fair and open market for the major portion of like-quality...gas...produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value." This is a market test. The regulation makes two exceptions to this test: first, if the Secretary can show "good reason" why this test should not be used and second, if the net proceeds to the producer exceed the market price. "Just and reasonable" as that term is used in Order 23 refers to term of art used in Sections 4 and 5 of the Natural Gas Act (NGA). Prior to the NGPA, maximum legal prices for natural gas sold in the interstate market were determined under Sections 4 and 5 of the NGA. Maximum legal prices were set by the FPC on a "just and reasonable" basis. While these prices were determined in various ways at various times, basically they were determined on the basis of the cost of obtaining the gas through drilling, completing, etc., plus a "reasonable" profit for the producer. In other words, the basis for determining "reasonable" for 30 C.F.R. 221.47, which is a market or proceeds determined price, is an entirely different price from those determined under the NGA, which were a cost plus reasonable profit basis. The term "reasonable," under these circumstances, just means two different things.

What the FERC is saying in Order 23 when it talks about "reasonable" is that under Section 104 (Existing Interstate

Contracts) of the NGPA, the FERC retains jurisdiction under the NGA for determination of "just and reasonable" and that determination, on a cost plus a reasonable profit basis, has been made by Congress, rather then requiring rate proceedings by the FERC that were conducted under the NGA. It has nothing to do with Section 105 and the term "reasonable" as used in 30 C.F.R. 221.47.

The conclusion is clear. The argument that Mr. Panella makes that the NGPA maximum legal price is a reasonable price based upon Order 23 statement that Section 104 prices are reasonable, is just a misunderstanding of the statutes involved.

Although Mr. Panella doesn't mention it, NTL-5 may be applicable here. It provides, in part:

> II. Intrastate and Other Sales or Dispositions Not Subject to Price Jurisdiction of the FPC
>
> A. Establishment of Royalty Values
>
> * * *
>
> 2. For sales from wells commenced on or after June 1, 1977, and which are subject to an arm's length contract entered into prior to, on, or after that date; for sales made pursuant to an arm's-length contract renegotiated on or after that date; and for all sales or other dispositions not involving an arm's-length contract, the base value for royalty purposes shall be established as the higher of:
>
> a. The price received by the lessee or operator in accordance with the provisions of the applicable sales contract, or
>
> b. The highest price paid or offered for a majority of like quality gas produced in the field or area. Provided, however, That if such information is not readily available, or the highest price paid or offered for said majority of like quality productions does not reflect the reasonable value of the gas, the Supervisor may determine the base value as the highest applicable national rate then currently established by FPC for the same vintage gas.

The rule is that the FPC price can only be used if (1) the highest price paid or offered in the field for the majority of like quality gas is not readily available, or (2) the highest price paid or offered is not "reasonable", as found by the Supervisor. It has been stated over and over that the majority of gas in the field is Planet's and Mr. Thompson's. There is no showing that their price is unreasonable. The argument that under Order 23 maximum legal prices are "reasonable" because they are "just and reasonable" doesn't apply here, either.

As to that part of Mr. Panella's arguments that Mr. Thompson could have had Section 103 prices any time after February 1, 1979, the law and the regulations are clear that the premise upon which this argument is built is just incorrect.

B. Argument - TXO's price cannot be used as a comparative price.

In this part of his argument, Mr. Panella states that the TXO price was not used or intended as a comparative price for determining price for royalty purposes. We assume this to mean that he agrees that the TXO price cannot be used to determine "reasonable" price under 30 C.F.R. 221.47 or it repreents the majority of the gas in the field. We agree that it should not and could not, under the regulations, be used in this manner. He then goes on to make two statements that are the essence of his argument. They are:

> Not only was gas from other NGPA Section 103 wells receiving NGPA 103 prices, but so was gas from Mr. Thompson's own well, a full year before he started to receive NGPA Section 103 prices. (Page 7, Panella Memorandum.)
>
> The other interest in the Stark No. 1 did not receive the NGPA Section 103 price at the first available time either, but they did receive the price a year before Mr. Thompson, thus further demonstrating the Section 103 prices were legally obtainable for the Stark No. 1. (Emphasis added.)

These statements raise three arguments. First, it is suggested, in the first sentence, there are other wells receiving Section 103 prices in the field. We have asked for this information and there is no showing in any of the proceedings that this statement is any more than pure conjecture. No well, contract or location is ever mentioned in any of the proceedings other than the Stark No. 1 Well. Mr. Panella's statement could also be taken to mean that all Section 103 qualified wells were getting Section 103 prices on February 1, 1979. They were, but not if they were also Section 104 and 105 wells, at least not legally. Second, Mr. Panella repeats his argument that even TXO did not receive the Section 103 price at the earliest time possible. This again goes back to Mr. Panella's beliefs that a Section 103 qualified well could always get Section 103 prices, which we have already shown to be false. Third, Mr. Panella points out that TXO received the Section 103 price one year earlier than Mr. Thompson. The reason for this, including the possibility of a Section 102 price, is the inability to get Peoples to negotiate; and TXO sale to Nueces, and not Peoples. This is all discussed in Thompson's Appeal. The arguments were never addressed by Mr. Panella and will not be argued further.

C. Argument - The NGPA Section 103 price could not be received by Mr. Thompson because of FERC regulations.

Mr. Panella in this part of the argument again repeats his mistaken belief that a Section 105 contract could be terminated by its own terms and then re-negotiated as a Section 103 contract. As we have seen, a terminated Section 105 contract, prior to the FERC's permission to re-negotiate, is just a Section 106(b) contract, not a Section 103.

D. Argument - Purchaser was unwilling to negotiate for a higher price.

Mr. Panella's argument in this section is just a repeat of his previous arguments conerning when he thought that Mr. Thompson could have terminated the May 1 Contract and received Section 103 pricing. However, Mr. Panella also mis-states the argument made in Thompson's Appeal. The point made, and which will not be repeated in full here, is that up to a point the regulations prohibited re-negotiation, which was the only way that any thing other than the Section 105 or 106(b) price could be obtained. After that, every reasonable effort was made to obtain a new contract at the best price, including a lawsuit. Under the regulations, Peoples was not obligated to re-negotiate with Mr. Thompson. In fact, Peoples did refuse to negotiate for a period of time. The price received by Mr. Thompson was the reasonable price for the gas, given the circumstances of the negotiations and the best obtainable price in the field.

E. Mr. Panella's Conclusion

Mr. Panella's conclusion is merely a reiteration of his basic argument:

1. The Stark No. 1 Well qualified as a Section 103 well.

2. The May 1, 1978, Contract could have been terminated on January 31, 1979.

3. Any well that qualified as a Section 103 well was qualified to receive Section 103 pricing.

4. Mr. Thompson's purchaser was not unwilling to give him the Section 103 price, just because it was ignorant that the Stark Well qualified as a Section 103 well.

5. All Mr. Thompson had to do was to terminate the May 1, 1978, Contract to receive the Section 103 price.

6. Therefore, Mr. Thompson should pay royalty on the Section 103 price from February 1, 1979.

As has been shown, this argument is neither legally correct nor factually correct. It should be rejected.

Under both 30 C.F.R. 221.47 and NTL-5, contract price can only be rejected if there is an affirmative showing that the price was unreasonable. No showing has been made that the price was unreasonable or that the Supervisor ever made that decision.

III. GATHERING ISSUE

A. Gathering charges after June 1, 1981

The arguments made by both Mr. Penella and Thompson's Appeal in this part of the argument are incorrect. In order to have a complete understanding of why both parties were wrong, we must first re-state some of the facts of this case.

Mr. Thompson and Planet entered into a gas contract of May 1, 1978 (May 1 contract). This contract provided for a 25¢ per MCF gathering charge. On November 9, 1978, the NGPA was enacted. Construction of the gathering system began before this date. Under the NGPA, the May 1 Contract was a Section 105 contract. In the early part of the administration of the NGPA, the FERC prohibited parties from re-negotiating their contracts. When that changed, Mr. Thompson entered into a separate contract on October 1, 1981, (hereinafter "October 1 contract") for the sale of his gas at Section 102 prices. The October 1 contract also had a gathering provision in it which provided:

> 3. In addition to the prices set forth in Subparagraphs (1) and (2) above Buyer agrees to pay Seller a gathering allowance equivalent to the maximum lawful allowance as set forth under Section 110 of the NGPA provided always however such allowance shall not exceed twenty-five cents (25¢) per MCF. (p. 19A, Exhibit D, Thompson's Appeal)

Beginning October 1, 1981, Mr. Thompson began to receive the Section 103 price, but, through a mutual mistake, he was not paid the gathering charge.

In negotiating the October 1 Contract, Mr. Thompson also negotiated a side letter which provided that if Planet was able to negotiate a contract in which Planet got Section 103 pricing at an earlier date, then Mr. Thompson would also get Section 103 pricing from that date. Subsequently, Planet negotiated a starting date of June 1, 1981. Mr. Thompson was paid the Section 103 price to that date, but the gathering allowance was deducted. Royalty was paid on the Section 103 price between June 1, 1981, and October 1, 1981, but no gathering royalty was paid.

It was Mr. Thompson's belief, and Peoples', at the time that he began to receive Section 103 pricing that he could not receive the 25¢ gathering allowance under the NGPA regulations. This was the position in Thompson's Appeal. Subsequent research has found the position taken in Thompson's Appeal to be incorrect for the following reasons.

First of all, it should be remembered that nothing in the NGPA requires Peoples to re-negotiate. Nothing in the May 1 Contract required Peoples to re-negotiate. Therefore, the October 1 Contract is the result of the give-and-take of negotiation. Secondly, contrary to what Mr. Panella asserts in his Memorandum, Mr. Thompson could not have his cake and eat it too. That is, he could not amend to get Section 103 prices and retain an additional price in excess of the Section 103 price under the Section 105 provisions. He could not amend a contract to provide for a price in excess of that permitted under Section 103 and a gathering allowance would be considered to be in excess of the Section 103 price. The parties' gathering provision above reflects that awareness.

It was not until Order 94-B that the FERC addressed the issue of Section 110 gathering allowances. [48 Fed. Reg. 5180 February 3, 1983)]. In Order 94-B, the FERC permitted operators who had a gathering system, construction of which began prior to November 9, 1978, and who had not amended the terms of their contract after March 7, 1983, to include gathering allowances, to collect the amount in the contract under the provision of Section 110. See: FERC Regulations, Section 271.1104, and Order 94-B, supra.

Mr. Thompson has been negotiating with Peoples for the last two months to try to convince them that he comes under this regulation. Peoples finally agreed last week. However, there is one slight problem. Order 94-B was not made retroactive and the effective date is March 7, 1983. It, therefore, appears that under the regulations and his contract, Mr. Thompson will not be able to legally collect the gathering charge after June 1, 1981, to March 7, 1983. After that, Mr. Thompson will collect at the rate of 25¢ per MCF. Under the regulations and his contract, Mr. Thompson cannot collect his gathering allowance from June 1, 1981, to the time he was permitted to under Section 110. That date is March 7, 1983. Again, if MMS seeks royalty on the gathering allowance during the period from June 1, 1981, to March 7, 1983, it is claiming royalty on a price that Mr. Thompson could not collect.

B. Allowances before June 1, 1981

The issues as to the gathering allowance prior to the June, 1981, date are fully set forth in Thompson's Appeal and will not be repeated here. There is, however, one matter that is raised by Mr. Panella's Memorandum that cannot be left unchallenged. Mr. Panella refers to Conservation Division Manual (CDM) Part 647.5.3.D which states that cost of transportation cannot be deducted if delivery is in the same field. He then goes on to state, apparently including the statement by mistake in the quote from CDM, that the delivery is in the same field. There is no basis in fact in any of the pleadings or letters to assume this fact.

Next, Mr. Panella suggests that an allowance for a transportation allowance could be made in the future if proper application were to be made. Application was made in the manner suggested by the MMS's Mr. Dial. See: Exhibit J of Thompson's Appeal.

IV. CONCLUSION

Mr. Panella's position is summed up in one sentence in his memorandum: "Royalties are being assessed on what was actually received by Mr. Thompson or what should have been received." (Emphasis added.) (p. 14, Panella Memorandum.) In some instances, what Mr. Panella believed Mr. Thompson should have received was in excess of what he could have received under the NGPA. In other instances, Mr. Panella assumes that Mr. Thompson should have received a price without reference to material facts and are just supposition that Mr. Thompson might have been able to get this price. This makes Mr. Panella the judge of some very delicate and often harsh negotiations to which he wasn't a party. What Mr. Thompson "should have received" is strictly a subjective criterion. It has no basis in fact in a market criterion of 30 C.F.R. 221.47 or NTL-5, nor does it have a reasonable basis as required by these rules.

V. INTEREST RATES

In a separate demand letter dated November 17, 1983, the MMS demanded interest on the $61,910.27 which was in issue above. Mr. Panella wrote a separate memorandum dated July 20, 1984, on this issue of interest (hereinafter "Interest Memorandum"). On August 8, 1984, Mr. Hess ordered the two matters considered together.

Mr. Panella's Interest Memorandum raises some other questions. First, in the area of Incorrect Interest Rates, the last sentence appears to say that Mr. Panella admits that he used the wrong interest rate and that "...will be corrected." It has not.

As to MMS Delays, Mr. Panella mis-states the record. While it is true that from time to time Mr. Thompson has asked for continuances in order to obtain information or negotiate with Peoples, it should be pointed out that these are for relatively short periods of time. This matter began with a September 23, 1982, demand for $19,323.26. Mr. Thompson has made at least four major filings to answer these and other accusations that were made along the way. It was not until May of 1984 that he was able to get past the local level. As far as can be seen, only delay has occurred and Mr. Thompson's arguments still have gone unanswered and unreviewed. Mr. Thompson stands by his Appeal, attached hereto and incorporated by reference. The lack of notice is clear, as evidenced by the confusion in trying to consolidate these appeals.

Sincerely yours,

YOUNG, ALLOTT, FOSTER & REYNOLDS
ORIGINAL SIGNED BY
GORDON L. ALLOTT, JR.

Gordon L. Allott, Jr.
Attorneys for J. C. Thompson

cc: Mr. J. C. Thompson

No response.
file closed pending
further action
JEP
5/22/86

February 28, 1986

Wyoming State Auditor
State Capitol Building
Cheyenne, Wyoming 82002

Attn: Mr. James B. Griffith

Re:
Armor Federal #1 and #2 Wells
Well Draw Field
Federal Lease 49-000548
Converse County, Wyoming

Dear Mr. Griffith:

We have received the results of your audit of the above-referenced lease for the period January 1979 through November 1983. After reviewing your letter, we are unable to concur with your findings.

Specifically, we do not believe that the "BTU Method" of calculating royalties is appropriate in this particular situation. The BTU Method provides that the value of unprocessed gas is obtained by multiplying the base contract price per Mcf by the BTU content at the lease/wellhead. Application of this method seems to necessarily require that the lessee's gas sales contract contains a "base price per Mcf."

Although Home does sell its Armor Federal #1 and #2 gas in an unprocessed state, our gas sales contract contains a rather complicated pricing mechanism that does not rely on a "price per Mcf" or per MMBTU. Instead, Home sells its unprocessed gas to Phillips, who processes the gas, sells the products and residue gas, and then pays Home a percentage of the sale price of the products and plant residue gas.

These wells are primarily oil-producing, with low volumes of associated gas. Because there is no market for the low pressure, casinghead gas from these wells other than gas processors such as Phillips, the price Home receives is, practically speaking, the highest price we are able to obtain for our gas. We would therefore urge that the proceeds Home receives for the gas is the proper basis for computation of royalty.

Thank you for your consideration of our position. If you would like to have further information, please contact me at (303) 296-5027.

Yours truly,

Jan E. Potts
Senior Attorny

JEP/gls

cc: Ed Starz

Mr. Todd McCutcheon
Minerals Management Service
Mail Stop 626
Post Office Box 25165
Denver, Colorado 80225

THE STATE OF WYOMING

Wyoming State Auditor

STATE CAPITOL BUILDING CHEYENNE, WYOMING 82002

JAMES B. GRIFFITH
STATE AUDITOR

(307) 777-7831

DAVID G. FERRARI
DEPUTY STATE AUDITOR

January 14, 1986

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Home Petroleum Corp.
One Denver Place
999 - 18th Street
Denver, CO 80202

RE: Well Draw Field
Federal Lease 49-000548
Converse County, Wyoming

Gentlemen:

The Wyoming State Auditor's Office has been delegated the authority by the Secretary of the Interior to perform audits and related investigations of federal oil and gas leases located in the state of Wyoming. This authority is in accordance with Section 205 of the Federal Oil and Gas Royalty Management Act of 1982.

We have reviewed oil and gas production/sales for the period January 1979 through November 1983. This letter is intended to apprise you of a preliminary royalty underpayment determination resulting from our review, and does not consititute a final action or determination by the Wyoming State Auditor nor the Minerals Management Service. Its purpose is to give you an opportunity to comment or provide any additional documentation that would refute our preliminary findings.

SCOPE

We reviewed sales for the period January 1979 through November 1983 involving federal lease 49-000548, and included the examination and verification of the following:

1. MMS Form 9-1424 (Statement of Account)
2. BLM Form 9-329 (Monthly Report of Operations)
3. Form MMS-2014 (Report of Sales and Royalty Remittance)
4. Phillips Petroleum Company's Gas Plant Statements

BACKGROUND

Federal lease 49-000548 is a straight lease issued to William C. Armor, Jr. on September 1, 1966 containing 320 acres of federal land located in Sections 21 and 34, Township 34 North, Range 68 West, 6th Principal Meridian, Converse County, Wyoming.

Attributable production is from wells Armor #1 and #2 completed November 17, 1974 and April 28, 1975, respectively. In addition to oil, both wells produce casinghead gas.

HPC, Inc. has operated the property since January 1, 1981 on assignment from the Davis Oil Company.

FINDINGS

GAS

IMPROPER ROYALTY VALUE

Federal regulations and instructions establish the value to be used in calculating royalties for the referenced lease. "Notice to Lessees and Operators of Federal Onshore Oil and Gas Leases" (NTL-1) Part III states in part:

> "The value of all produced gas and associated liquid hydrocarbons will be established by the Supervisor. Such value will be based on value of both the natural gas and its entrained liquid hydrocarbons with due consideration being given to highest price paid for a majority of like quality production in the same field or area, to the price(s) received by the operator, to the Btu content of the gas, and to other relevant matters.
>
> The Supervisor may adjust royalty values to reflect the Btu content of the gas regardless of whether the gas is sold on that basis. The Supervisor may also redetermine the value of the gas for royalty purposes at any subsequent date should such action be required to reflect the reasonable value of the gas and its entrained liquid hydrocarbons."

In addition, the Minerals Management Service Royalty Management Program's Payor Handbook, Section 3020.20, informs payors they must pay royalties on gas on the following method which yields the greatest royalty.

?

NGPA ceiling price

we sell
60% products
17½% residue

BTU Method (Unprocessed or Wet Gas).--Royalty will be computed on the value of unprocessed gas. The value of unprocessed gas is obtained by multiplying the base contract price per MCF by the BTU content of the gas at the lease/wellhead.

Net Realization (Processed Gas--Residue Plus Plant Products).--Royalty will be computed on 100 percent of the value of all residue gas remaining after processing plus 100 percent of the value of all plant products allocable to the lease, minus a manufacturing allowance for plant products when approved by MMS.

Gross Proceeds.--The actual value of gas and plant products accruing to the lessee from the sale of natural gas.

In accordance with Federal regulations and instructions set forth by the Minerals Management Service, we have valued the "wet" gas at the lease using actual wellhead sale volumes provided in Phillips Petroleum Company's gas plant statements and BLM Form 9-329. The appropriate NGPA base ceiling price (104) was applied and volumes were adjusted by the reported wellhead Btu (Schedule A).

Schedule B attached indicates actual tax reimbursements received through the audit period.

Schedule C attached (Statement of Differences) incorporates the values in Schedules A and B and further reflects the royalties due on our computation of the "wet" gas value.

SUMMARY

Gas Sale Delinquency (49-000548)	$34,457.95

We request you review the information contained in this letter and supporting schedules and advise us no later than February 12, 1986 of your concurrence or specified reasons for nonconcurrence.

This letter is to advise you of a potential underpayment of MMS royalties on the referenced lease and should not be interpreted to be an official order to pay. However, if a formal response addressing the findings is not received by February 12, 1986, an official order to pay the additional royalties, as stated, will be issued by the MMS. Your response should be sent to:

Wyoming State Auditor's Office
P.O. Box 2495
Casper, WY 82602

If you desire to voluntarily remit payment based on the contents of this issue letter, your payment must be accompanied by a green MMS Form-2014. Attached are instructions and forms for your use. Inquiries concerning this letter or enclosed computation schedules should be addressed to Mr. Shane Noel at (307)261-5150.

If you have any questions concerning the attached instructions for green Form MMS-2014, please contact your Lessee Contact Branch representative or call (303)231-3288..

Sincerely,

James B. Griffith

James B. Griffith

Enclosures
cc: Mr. Todd McCutcheon, MMS

Mail Stop 626
PO 25165
Denver 80225

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DENVER, COLORADO 80202
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BONNIE S. MANDELL-RICE

June 30, 1986

Senate Committee on Energy
and Natural Resources
United States Senate
Washington, D.C. 20510

RE: Appeals pending before the Minerals Management Service

Dear Senators:

Barry Snyder recently testified on behalf of the Independent Petroleum Association of Mountain States (IPAMS) at Committee Hearings concerning comprehensive oil and gas legislation. Following his testimony, certain of you inquired of Mr. Snyder as to the circumstances giving rise to the numerous appeals presently pending before the Minerals Management Service ("MMS"). Knowing that we represent a number of oil and gas companies (including Apache Corporation, Canterra Petroleum, Inc., Farmers Union Central Exchange, and Patrick Petroleum Corporation) in connection with such appeals, IPAMS has asked us to write to you on its behalf in response to those inquiries.

The appeals in which we are involved are in response to MMS' allegations (either in letters advising our clients of a "preliminary determination" that monies are owed or in a bill for collection or other present demand for payment) that the company owes the United States additional royalty or other compensation for natural gas produced from Federal leases operated by the company.

The circumstances giving rise to the various appeals (the "Appeals") with which we are involved are described below:

I. APPEALS OF MMS CLAIMS THAT COMPENSATION ALLEGEDLY IS DUE THE UNITED STATES FOR GAS FLARED FROM OIL WELLS SITUATED ON FEDERAL LEASES WITH THE APPROVAL OF THE STATE REGULATORY AUTHORITY, BUT WITHOUT THE PRIOR WRITTEN APPROVAL OF THE BUREAU OF LAND MANAGEMENT.

The Federal leases involved in the Appeals (the "Leases") are non-competitive leases, issued pursuant either to Section 17 of Mineral Leasing Act of February 20, 1920 (30 U.S.C. §§181-263) or to the Act of August 17, 1947 (30 U.S.C. §§351-359), covering public domain or acquired lands in North Dakota. Consistent with the dictates of those statutes, the Leases all require that the lessee operate with due regard for the prevention of waste. Numerous oil wells (the "Wells") have been drilled on the Leases. The Wells produce gas in association with the oil.

A. Gas Flared Due to Lack of a Pipeline.

At the times the Wells were completed, no pipeline was available to take the gas they produced. In some instances, because of the sufficient development of, and the estimated gas reserves contained in, the particular field in which a Well was located, it was anticipated that pipeline connections would become available within a year or so after Well completion. In other instances, because of the distance of the Wells from the nearest pipeline and the lack of adequate gas reserves and development in the particular field, pipeline connections would not and may not be available unless the lessee/operator ("Operator") were to bear the costs of laying pipe from the pipeline to the Wells.

Regardless of the circumstances giving rise to the lack of pipeline connections, that lack presented the Operators with three choices as to each Well: (1) shut-in the Well and forego the production of oil; (2) produce the oil and vent or flare the gas; or (3) produce the oil and reinject the gas. In those instances where it was apparent from the outset that pipeline connections to the Wells would not be made available by the pipeline companies, the Operators had a fourth choice: to bear the cost of laying the pipeline. As discussed below, the only prudent alternative was to produce the oil and flare the gas.

Shut-In Option. Given the relative quantities and values of the oil and gas, as shown by the tests run on each Well, the Operators determined that it would be economically wasteful to shut-in their respective Wells. The propriety and prudence of the decisions to produce rather than shut-in the Wells are borne out by the production data. During the periods (the "Audit Periods") for which MMS claims additional compensation is due the United States, the value of the gas flared from each of the Wells, as determined by MMS, represented only a small percentage of the total value of production (oil and gas combined) from each Well.[1] The United States received significant royalties during the Audit Periods based on the production of oil from the Wells. Those royalties were based on the high prices for which oil was being sold in the early years of this decade.[2]

Pipeline Construction Option. In those instances where it was apparent that a pipeline company would not be making connections available to the Wells, the Operator, having determined that it would be imprudent to shut in the Wells, had to decide whether to bear the cost of laying a pipeline to the Wells or simply to flare the gas. In making that decision, the Operators weighed those costs against the revenues that might be expected to be derived. Such an analysis showed, in each instance, that the costs of installing a pipeline exceeded both the value of the gas alone and, after deductions for the cost of oil operations, the income from the oil producible from each Well. Based on those findings, the Operator of a number of the Wells determined that conservation of the gas could not be economically justified. In another instance, the Operator of one of the Wells ultimately agreed, notwithstanding that the costs exceeded revenues, to bear the cost of laying the line.

---

[1] In some instances, the gas flared represented only 5.69 percent of the total value of the production.

[2] In the majority of instances, the oil prices exceeded $32.00 per barrel throughout the Audit Periods.

Reinjection Option. Having determined that it was prudent to produce the oil notwithstanding the lack of a pipeline to take the gas, the Operators had to decide whether to flare the gas or reinject it. Reinjecting the gas into the Wells was not feasible from an engineering standpoint.

Flaring Option. In each instance, the North Dakota Industrial Commission (the "Industrial Commission") had approved, after public notice had been duly given, the flaring of gas from the fields in which the Wells were situated. In each instance, such approval was given prior to completion of the Wells. The United States entered no objection to the Industrial Commission's Orders resulting from and evidencing such approvals.

Thus, based on the information available to them, each Operator believed, and still believes, that the flaring of gas from the Wells in order to permit continued production of oil was proper and done with due regard having been given to the prevention of waste, and was approved and sanctioned by the State of North Dakota and the United States. All flaring prior to the dates the Wells were connected (if connected) to the pipeline was done in accordance with the Industrial Commission's Orders.

Pipeline connections later became available to take the gas produced from certain of the Wells. In those instances, the Wells were connected to the pipeline, and sales of the gas not used on the particular Lease commenced, as soon as the pipeline was available. In other instances, pipelines connections still are unavailable.

The United States was aware at all times of the foregoing circumstances in each instance as a result of the various completion, production, royalty remittance and other reports filed by the Operators from time to time prior to and during the Audit Period. Nevertheless, in the majority of instances the United States did not advise the Operators of any impropriety until the MMS made claims upon them for compensation in an amount equal to the full value of the gas flared, which claims have resulted in the Appeals. In other instances, the United States did communicate with the Operators concerning the flaring. In those instances, the United States either indicated that the flaring would be considered justified under the circumstances or gave its approval to the continued flaring. Notwithstanding such indications or subsequent approvals, MMS claims compensation due for gas flared prior to the date of the actual written approval.

B. Gas Flared Due to Pipeline Equipment Malfunctions.

As previously stated, pipeline connections ultimately became available to a number of the Wells, and connections were made and sales commenced. In a number of instances flaring subsequently has occurred due to line failures and equipment malfunctions. During normal operations, venting or flaring does not occur. Periodically, however, the line pressure exceeds the designed operating pressure of the production from the particular Lease. This abnormal situation, being a result of a problem in the purchaser's gas collection system, causes the pressure relief valves on the production equipment to release gas to flare. Gas is flared until the problem is eliminated and the gas sales resume. The flaring that occurred subsequent to the connection of various Wells to the pipeline was reported to MMS on a monthly production report. Nevertheless, MMS did not communicate with the Operators regarding the flaring nor had it given the Operators any reason to believe that the flaring of the gas under those circumstances would be improper.

II. APPEALS OF MMS DETERMINATIONS OF THE VALUE OF GAS ON WHICH ROYALTY OR OTHER COMPENSATION IS OR MAY BE DUE.

Appeals of MMS' determinations of the value of gas have arisen in two contexts. First, such Appeals are part of the Appeals described in Part I above. In that context, the compensation MMS claims to be due the United States is based on 100 percent of the value of the gas. In determining the value for that purpose MMS, in each instance, has assigned to the gas flared the NGPA Section 102 price, which is the maximum lawful price allowed by the Federal Energy Regulatory Commission without regard to whether that was the price which the operators would have received had they saved and sold the gas.

The second context in which MMS determinations of the value of the gas has arisen is in connection with demands for additional royalty payments. In those cases, the Operator has paid royalties based on the contract price received, which price may be tied to a percentage of the NGPA maximum lawful price. MMS, however, has demanded royalty payment based on the applicable royalty rate multiplied by 100 percent of the NGPA maximum lawful price for the highest price category for which the gas could qualify.

Regardless of the context in which the Appeals arise, the crux of the matter is whether MMS properly may value gas at 100 percent of the NGPA maximum lawful price, without regard to the following:

1. The price that would have been received had the gas not been flared (in the case of flared gas);

2. The price that actually was received in the case of the gas sold (the "saved gas") on which additional royalties are claimed by MMS;

3. The price received by other gas producers in the area;

4. The fact that the flared gas would have to be, and the saved gas was in many instances, processed in order to be sold;

5. As to processed gas, the royalty payable on flared gas would have been, and the royalty paid on the saved gas was, the greater of (a) the gross proceeds actually received for the sale of the gas, or (b) the value of the residue and liquids less an amount equal to two-thirds (2/3) of the value of the liquid; and

6. The price received by the Operator for flared gas would have reflected the cost of

Senate Committee on Energy
 and Natural Resources
June 30, 1986
Page Seven

> tying in the wells and transportation, which costs should have been considered in accordance with MMS regulations and policy.

We hope this report has been of assistance to you. If you would like further information, please feel free to contact us.

Very truly yours,

PARCEL & MAURO

Bonnie S. Mandell-Rice

BSMR:lsd

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

ACTUAL AND PROJECTED IMPACTS OF INCREMENTAL PRICING AND THE FUEL USE ACT ON NATURAL GAS SALES BY SOCALGAS

Incremental Pricing

Beginning in March, 1984, Southern California Gas Company (SoCalGas) applied for and received from the FERC a series of exemptions from incremental pricing for its 38 Enhanced Oil Recovery (EOR) customers in the San Joaquin Valley. In the most recent decision (February 1986), the FERC granted SoCalGas a permanent exemption from incremental pricing regulations for natural gas sales to EOR customers under any rate schedule authorized by the California Public Utilities Commission (CPUC), provided all such sales are made at rate which contribute to margin. SoCalGas is required to file an annual report with the Commission quantifying the related benefits received by its high-priority customers. The EOR market is unusual in that the alternate fuel is the crude oil produced through EOR production rather than the higher priced No. 6 fuel oil on which the FERC's alternate fuel price ceilings are based.

SoCalGas has approximately 40 customers which are still subject to FERC's incremental pricing regulations. The utility's sales rate to these "non-exempt" customers is established by an oil-price index formula in tariffs on file with the CPUC. For the first time in several years, the calculated rate resulting from the indexed formula was less in January and February, 1986, than the published EIA alternate fuel cost rate for the same calendar months. SoCalGas was, therefore, required to charge non-exempt customers the higher EIA rate for the first two months of this year. The competition created by declining oil prices has already taken a toll in the utility electric generation (UEG) market, causing SoCalGas to lose to oil the UEG requirements of San Diego Gas and Electric Company. While UEG customers are not subject to incremental pricing, the level of competition with oil for sales to UEG customers is indicative of what SoCalGas expects in the future with regard to its non-exempt customers. The ability of end-users to obtain gas directly at the wellhead, with the spread of interstate and intrastate transportation, is now far greater than could have been anticipated when the NGPA was enacted. However, incremental pricing interferes with pipelines' and LDC's abilities to offer sales gas to end-users at a price competitive with the end-user wellhead purchase option.

Fuel Use Act

Cogeneration Market

The FUA has affected the Southern California cogeneration market by adding the costs of filing for exemptions and discouraging future projects from being planned. Repeal of the FUA would eliminate filing fees and encourage future growth of this emerging market.

SoCalGas estimates its total cogeneration sales will grow throughout the next 7-10 years, reaching 115 Bcf. This will equate to a total capacity of 2200 megawatts of electric power by 1995. Gas will satisfy the requirements of two separate and distinct cogeneration markets: industrial/commercial process-associated cogeneration (45 Bcf) and EOR-associated cogeneration (70 Bcf).

The largest potential growth market for natural gas in the United States is the EOR and related cogeneration market within the San Joaquin Valley, estimated at 1000 MMcfd. Other non-EOR potential gas growth markets will be in cogeneration applications using fuel cells, gas engines, or turbines. By 1990, 36 Bcf/yr will be consumed by fuel cells or gas engine cogeneration systems. Gas turbines will represent 28 Bcf/yr.

UEG Market

Due to air quality constraints, no UEG facilities have been built in Southern California since the FUA was enacted. At this time no UEG facilities are being planned. Expansion plans are for a coal burning facility in Nevada and a nuclear plant in Arizona.

If the FUA were repealed, the potential exists to repower retired UEG facilities or to build new highly efficient combined cycle plants. The benefits of these alternatives include lower building costs, lower operating costs, and ultimately, lower utility costs for consumers.

SoCalGas estimates repowering of gas-fired plants scheduled for retirement could increase gas sales by 30 Bcf/yr over current forecasted sales in the mid-1990's.

If UEGs do not add new gas-fired generation facilities to meet increasing electrical demand, SoCalGas' market share is estimated to fall from 35% in 1985 to 20% by the year 2000.

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Industrial Market

SoCalGas believes the major decline in its industrial gas requirements over the past 6 years (1980-1985) is due in part to the FUA. Although the exact impact cannot be determined, industrial demand has dropped 35%, or 63 billion cubic feet a year. The five largest industrial customer classes, stone-clay-glass, food products, primary metals, chemicals, and petroleum refining have declined 27%, 29%, 40%, 52.2%, and 65.3% respectively. Petroleum refining, SoCalGas' largest industrial customer class in 1980, was fifth in 1985. If the FUA is repealed, this decline should be less significant.

STATEMENT OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS

BEFORE THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
NATURAL GAS LEGISLATION
MAY 20, 1986

NAM is a voluntary business association of over 13,500 companies, large and small, located in every state. Our members range in size from the very large to over 9,000 small manufacturing firms that each have less than 500 employees. NAM member companies employ 85 percent of all workers in manufacturing and produce over 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

Decontrol of natural gas prices is not a new issue. We continuously come back to Congress for help because we feel it is vital to our nation's industrial competitiveness, to our economy, and to our national security.

Natural gas is a major source of energy in the American economy. Since 1960, it has provided about one-third of all domestically produced energy. Industry consumes about 40 percent of all natural gas used in the United States. Natural gas is easily transported, has clean environmental properties, and can be used in process, feedstock and boiler applications. Because of its premium qualities, its price and supply are of vital importance to industrial consumers. NAM is therefore, most interested in legislative and regulatory proposals affecting natural gas.

The natural gas market, unfortunately, has been plagued by confusion and inefficiency resulting from a complicated 40 year history of federal government regulation. In fact, it is the only energy commodity that is price controlled by the federal government. These regulations have engendered a rigid and inflexible market unresponsive to the forces of supply and demand. Existing law prevents producers, pipelines and distributors from adjusting to changing market conditions. Industrial consumers are convinced that the price and supply of natural gas will suffer further distortion unless major changes are made. -

Congress passed the Natural Gas Policy Act (NGPA) in 1978. NGPA was intended to restore order to the natural gas market, yet many of its provisions contributed to increased uncertainty. The Act brought all natural gas production under federal regulation, removed general Federal Energy Regulatory Commission power over gas pricing and instituted a schedule of prices for the future. NGPA provided that the price of "new" gas (gas developed after 1977) would be allowed to rise at a rate slightly faster than inflation and would be deregulated in 1985. The price of "old" gas (gas developed in 1977 or earlier) would receive nonuniform regulatory treatment.

The intent of the law was to enable the controlled price of gas to reach its free-market price by 1985 through the partial decontrol initiative. To prevent price controls from leading to shortages, various regulatory barriers to gas consumption were instituted, such as the Fuel Use Act and incremental pricing. With all the intent of Congress to create a fair and equitable natural gas system, the NGPA is simply not working.

There is no better time than now to decontrol all natural gas prices. On January 1, 1985, wellhead price controls were removed from about 50 percent of domestic natural gas supplies. Partial decontrol has not led to price "fly-ups" as many predicted, but has instead decreased natural gas prices, increased competition and introduced greater market flexibility. This alone should be evidence that the marketplace and not the federal government is the best allocator of energy supplies. The NAM strongly believes that if the natural gas market were not regulated, but allowed to operate freely like all other energy markets, natural gas prices would decline.

Widespread support for comprehensive deregulation should be put forth by all segments of industry. One only needs to look at the results for oil deregulation in 1981 to see how the natural gas consumers and the U.S. economy will experience large economic benefits by full deregulation. Until total deregulation takes place, the marketplace will be hampered with distorted supply and demand signals caused by remaining price controls on old gas and the restrictive regulatory system imposed on the natural gas industry.

We believe it is obvious that artificial, below market price ceilings have negative supply repercussions. That, along with the inherent discrepancies between the interstate and intrastate markets, have resulted in:

1. A threat to national security;
2. A possible interference with reindustrialization and employment improvement;
3. A disincentive by some segments of society to conserve this precious fuel; and
4. Unfair competitive advantages and disadvantages amongst American industries.

By restraining domestic natural gas exploration and production, lack of decontrol has impeded the nation's ability to further reduce oil imports, thereby threatening the national security. As a result of deregulation of oil prices, conservation and other measures, the United States has made progress towards achieving the critical national goal of reducing dependence on costly, unstable sources of foreign oil. But there is still a long way to go to reach energy independence.

The nation is still dependent on foreign oil for over 30 percent of its petroleum needs. This dependence costs our domestic economy money, jobs and national security. Unless there are adequate economic incentives to produce domestic natural gas supplies, our susceptibility to oil imports will continue.

In addition, unless American industry has confidence that additional supplies of natural gas will be forthcoming, there could very well be increased hesitancy to proceed with contemplated expansions. Thus, an increased supply of natural gas would leave more money in this country and encourage industrial expansions. We believe that combination is important if reindustrialization is to be successful.

Deregulating natural gas will make more gas available now and in the future at realistic, market-related prices, and will help the nation's energy supply picture overall. Realistic gas pricing will encourage gas producers to drill for more gas.

Also vital to the natural gas market is the ability to foster competition by allowing open access to all producers and consumers. This would enhance competition by allowing all consumers access to the most inexpensive gas supplies. The Federal Energy Regulatory Commission has attempted to create a more competitive market by ordering a new rule intended to encourage pipelines to sign contracts to carry from producers' wells to gas users, such as industries and local gas utilities. This rule, however, has met many stumbling blocks over the past couple of months which have created such a chaotic atmosphere that the new order is not working effectively. This ruling and its aftermath only emphasize the need for legislation addressing open access for transportation of all gas.

The National Association of Manufacturers believes that current natural gas policy and the related regulatory structure benefits neither producers, users, nor the nation at large. The NGPA has clearly failed to meet the legislative intent of the Congress and its overall deficiencies are more apparent now than ever. The Fuel Use Act and the incremental pricing provisions of NGPA have introduced widespread inefficiencies and market disorders. NAM believes that the free-market, rather than the federal government, is the most efficient allocator of energy resources. NAM actively fought for total decontrol of the natural gas market in past Congresses.

In January 1985, the NAM's Board of Directors, consisting of this nation's leading industrialists and representing virtually every segment of American industry, overwhelmingly approved a policy reemphasizing the total deregulation of all natural gas.

NAM strongly advocates comprehensive reform of natural gas policy and supports the following principles:

- Price decontrol. Total decontrol of the wellhead price of all natural gas in an orderly manner;
- Contract Carriage. Establishment of nondiscriminatory mandatory contract carriage for natural gas based upon presumed pipeline capacity consisting of the reasonably foreseeable needs of present customers;
- Equal Access. Insure that all buyers have equal access to all supplies of natural gas;
- Demand Constraint. Repeal of incremental pricing and removal of mandatory demand constraints under the Powerplant and Industrial Fuel Use Act which limit flexibility;

- o Excise tax. NAM opposes an excise "windfall profits" tax on natural gas which would reduce the positive effects of decontrol;
- o Public lands. Make federal lands available for development in an orderly and reasonable manner.

Decontrol of all gas, old and new, would help eliminate the market disorders in the natural gas industry. Allowing the price of all gas to reach its true market level will encourage conservation by all users and spur additional exploration and production of natural gas supplies.

NAM supports each bill being considered by the Committee (S. 2285, S. 1302, S. 2205, S. 1251, and S. 834) as they are in line with our above stated policy. However, we want to make very clear that NAM supports a comprehensive approach to natural gas policy with each of our Board approved principles outlined above.

The NAM believes that total natural gas deregulation is good energy policy and that it must be accomplished now.

Testimony of
Carmen D. Legato, Esquire
on Behalf of
The National Association of State Utility Consumer Advocates and The Maryland People's Counsel

Introduction and Summary

My name is Carmen D. Legato. I am a member of the firm Swidler & Berlin, Chartered, in Washington, D.C. I am appearing on behalf of the National Association of State Utility Consumer Advocates (NASUCA) and the Maryland People's Counsel, a member of NASUCA. NASUCA is a membership organization of officials in 34 states that under state law are required to represent the interests of residential consumers and, in some cases, commercial consumers of natural gas and other utility services.

This hearing concerns, in part, a draft of proposed legislation submitted by the Administration entitled the "Natural Gas Transportation and Regulatory Reform Act of 1986." The other bills are similar in their overall effect to the Administration's proposal, though different in their particulars. The Administration's proposal has four principal parts: provisions concerning non-discriminatory transportation by interstate gas pipeline companies, provisions deregulating prices and eliminating non-price controls for "old" gas that was not deregulated by virtue of the Natural Gas Policy Act of 1978, a section eliminating restrictions on the use of gas contained in the Fuel Use Act of 1978 and a section repealing the incremental pricing provision of Title II of the NGPA. My testimony today focuses upon the first and second of these provisions, transportation and wellhead deregulation.

The remarks accompanying the Administration's bill make two important claims concerning the effect of these provisions. First, they characterize the bill as one substituting free-market forces for regulation, and second, they argue that the effect of this bill will be to more efficiently allocate resources and to reduce prices to consumers of natural gas. Support for these conclusions is premised on the success of deregulatory policies, in particular those concerning oil prices, and partial deregulation of natural gas in 1985 accomplished by the Natural Gas Policy Act of 1978 (NGPA).

Without in any way disagreeing with the Administration's premises that where a competitive marketplace exists, market forces will most efficiently allocate resources and yield the greatest net benefit to the economy and consumers as a whole, we must point out that the current bill contains critical flaws that preclude the accomplishment of such purposes. Rather than achieve a free market, the bill would perpetuate distortions arising from the ability of pipeline companies, which possess market power, to prevent independent producers of gas and consumers of gas in large segments of the consuming market from dealing with one another in a competitive marketplace. My testimony addresses these distortions which remain uncorrected by the Administration's proposal, and which would defeat the stated objectives of enhancing economic efficiency and of promoting competition. As discussed below, unless these flaws are addressed, the effect of this legislation would be to place an enormous "tax" primarily on residential and commercial consumers of natural gas that would unjustifiably further increase home heating bills above a market price and reduce gas consumption and net economic efficiency.

The "Open-Access" Transportation Proposal

The Department of Energy (DOE) correctly has stated that the market power of pipeline companies over essential bottleneck facilities, namely, the pipe essential to move gas from producing areas to market areas, has distorted the wellhead market, reduced competition and injured producers and consumers of natural gas. We strongly support the thrust of the Administration's proposals in Sections 101 and 102, which would require pipeline companies to transport gas in accordance with the Federal Energy Regulatory Commission (FERC) regulations governing self-implementing transportation by pipeline companies. The purpose of open access is to eliminate the monopoly that the pipeline has over the sales of gas and, instead, allow customers, like local distribution companies that purchase gas for residential and commercial consumers, to shop around among many pipelines or to purchase gas directly from the many producers or independent marketing companies.

As the Committee has observed, most interstate pipelines have failed to participate in Order No. 436 with the result that consumers are still unable to obtain transportation for gas purchased directly from producers. By section 102, the FERC would be able to remedy this situation by directing pipelines to offer transportation on non-discriminatory terms.

Nevertheless, the DOE proposal fails to achieve a truly "open-access" system of transportation; it would create greater access for one segment of the marketplace, namely, those large users that have the ability to switch from one fuel to another on relatively short notice (interruptible users) while withholding access to the competitive marketplace from residential and commercial consumers of natural gas until 1990.

The latter group -- residential and commercial consumers -- are what are called "firm" users of natural gas. That is to say, these customers have no alternatives to gas and therefore require that the delivery service provided by the pipeline company be on a reliable or non-interruptible basis. Pipelines have always been willing to provide transportation on a firm basis to distribution companies so long as the customer agreed to purchase gas from the pipeline as well. However, Order No. 436, while it provides for immediate non-discriminatory access to interruptible transportation services for gas purchased from others, allows the participating pipelines to retain their monopoly over sales to the residential and commercial market by phasing-in the requirement of firm transportation service over a five-year period.

Table 1 below shows the schedule under which Order No. 436 would allow pipeline companies to maintain a monopoly in sales of gas to the residential and commercial markets. As shown there, it is not until 1991 that the residential and commercial markets will obtain equal access to the competitive market place. The distinction in access afforded to firm and interruptible markets is crucial, because, as DOE has recognized, the prices charged by pipeline companies that are not subject to open access have been well above the prices available in the competitive marketplace.

Table 1

Opportunities for Pipelines to Pass Through Above-Market Prices to Residential and Commercial Consumers Under the Administration's Proposal

Year*	% of firm transportation capacity not accessible to gas supplied by others**
1987	85
1988	70
1989	50
1990	25
1991	0

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*FERC contract years which run from November 1 to October 31. For example, the year 1987 is for the period November 1, 1986 to October 31, 1987.

**Order No. 436-A, 50 Fed. Reg. 52217, 52274 (to be codified at 18 C.F.R. § 284.10(c) & (d)).

However justifiable a phase-in of non-discriminatory access to the transportation system might have been in the context of an administrative proposal of the FERC for a voluntary transportation program, it plainly is unjustified in a legislative proposal that purports to make comprehensive reforms to protect all consumers by reliance on free-market forces. The DOE proposal opens up the pipeline for access by large manufacturing plants while codifying the exclusion of residential and commercial consumers from the benefits of competition in the marketplace until 1991. To this extent, we are most vigorously opposed to this bill.

We urge the Committee to substitute for the DOE bill pertinent provisions of the bill introduced by Senator Bradley.[1] Under Senator Bradley's bill, local distribution companies purchasing for their system supply for use of their residential and commercial consumers would gain the same access to the marketplace for natural gas as would large manufacturing plants.[2] Under that proposal, unlike the DOE bill, the nation's consumers are not segmented into two camps: (1) the large manufacturing plants that are permitted to enter the competitive market place; and, (2) residential and commercial customers that are forced until 1991 to purchase gas -- at whatever price -- from pipelines that carry gas to that city. The same principles of the free market that require open access for some consumers require open access for all consumers.

In addition, the Bradley Bill, unlike the Administration's proposal, permits pipelines to reduce their purchase obligations to suppliers by an amount necessary to offset any reduction in volume of natural gas sold by the pipeline from its system supply due to transportation. S. 834, Section 316(e)(2), Vol. 121 Cong. Rec. S. 3851 (April 2, 1985). It is noteworthy that a similar provision giving pipelines take-or-pay relief where it lost sales to transportation was supported in the 98th Congress by among others, the Natural Gas Supply Association, Independent Petroleum Association of America and Natural Gas Equal Access. A copy of the Joint Statement of groups, including these organizations, supporting such a provision is attached. This Joint Statement, entitled "The Contract Carriage Coalition Compromise for Non-discriminatory Transportation," was widely circulated among the Senate and House Committees during the Second Session of the 98th Congress. There is no justification for excluding that provision from the Administration's Bill.

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[1] S. 834, Natural Gas Competition Act, Vol. 131 Cong. Rec. S. 3851 (April 2, 1985).

[2] E.g., Section 316(d), Obligation To Continue Service, Vol. 131 Cong. Rec. S. 3851.

NASUCA also urges that sections 101 and 102 make clear (as they presently do not) that all transportation must be undertaken pursuant to the terms of Order No. 436. While NASUCA believes that the FERC fell short of its statutory obligations to residential and commercial consumers in Order No. 436 in certain respects, which, as I explained earlier, should now be corrected, NASUCA believes that a pipeline should offer transportation services under a generic non-discriminatory program, such as Order No. 436, or not at all. Because the FERC recently has permitted interstate pipelines to offer blanket transportation pursuant to section 7(c) of the NGA without requiring the pipeline to comply with the requirements that the FERC found to be essential in Order No. 436 for blanket transportation to be considered nondiscriminatory, section 102 should be revised to make clear that all transportation must be conducted under uniform regulations.[3]

For this reason, the draft bill should be clarified to ensure that all transportation provided by interstate pipelines be pursuant to the requirements of Order No. 436. Only in this way will the discrimination and anticompetitive behavior that the U.S. Court of Appeals in the Maryland People's Counsel cases found to result from the FERC's previous transportation programs be eliminated, and the salutary effects of competition be realized in the natural gas industry.

The Proposal to Deregulate Well-Head Prices

On first blush, the proposal to lift price controls for gas developed prior to 1977 that was not deregulated by virtue of the NGPA appears to be in keeping with free-market principles that would yield the expected benefits of competitive markets. But such is not the case because of the particular way that DOE has shaped this proposal. As the DOE has recognized many times, one consequence of the partial decontrol brought about by the NGPA has been that below-market prices paid to producers for price-controlled, old gas permitted pipeline companies to pay above-market prices for gas that had been deregulated. Yet DOE now proposes to raise old gas prices to market levels while leaving new gas prices frozen at above-market levels.

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[3] *Texas Gas Transmission Corporation*, Docket No. CP86-143-000, dated February 14, 1986. In *Texas Gas*, the FERC authorized transportation service to 52 end-users who, prior to October 31, 1985, had been receiving service either pursuant to authority under section 157.209 of the Commission's regulations or pursuant to the special marketing program (SMP) authority of some other gas company, which were vacated by the Court of Appeals in the *Maryland People's Counsel* cases as anticompetitive and harmful to consumers. *Maryland People's Counsel v. FERC*, 768 F.2d 768 (D.C. Cir. 1985) (remanding SMP I); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (vacating order 234-B); *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (remanding SMP II). *Texas Gas* is unacceptable because it authorized interruptible service to some consumers without an *obligation to* provide *firm* service and, therefore, an opportunity for local distribution companies to gain meaningful access to suppliers other than the pipeline. In light of *Texas Gas*, the requirements of Order No. 436 have become merely options which pipeline may choose to ignore when it decides to offer "blanket" or "self-implementing" transportation.

The fact that new gas prices have been negotiated at above-market prices is well-documented by DOE and cannot be disputed. Over 40 percent of the current gas supply is old gas with an average price in 1985 of $1.44 Mcf, while the remainder is new gas with an average price of $3.78 Mcf.[4] The current market price, in contrast, is less than $2.00 Mcf. Some new gas is sold by producers directly to consumers on the free so-called "spot market." Gas sold on the spot market is sold at a market-price. The "new gas" sold by pipelines from their system supply, however, is sold to captive markets at prices dictated by long-term contracts that pipelines entered into during the period 1978--1983. During this period, pipelines, in reliance upon the below-market prices for old gas, agreed to purchase "new gas" at above-market prices. Under contracts which represent 52 percent of all NGPA Sections 102 and 107 new gas purchased by pipelines,[5] the price is fixed by indefinite price escalator clauses that operate in one direction only. These escalators took the prices up to a level well above the current market price, or the long-run equilibrium price for natural gas, and froze them there. The result is that pipeline companies are contractually obligated to pay above-market prices for gas.

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[4] Natural Gas Monthly, DOE/EIA-0130 (86/01), 1986, at pp. 11-13.

[5] Foster Associates, Inc., "Analysis of High Cost Gas Purchases by Contract Termination Date" (Washington, D.C., August 1985, for Policy Evaluation and Analysis Group, The American Gas Association) at p. 6.

The distorting effect of this high-priced gas is likely to continue well into the 1990s because of the relative newness and long-term nature of the contracts. Of the current high-cost gas transactions without market-responsive pricing provisions, 76 percent are from contracts executed since the passage of the NGPA in 1978[6] and are predominantly long term. Only 13 percent of non-market-sensitive, high-cost purchase contracts will terminate before 1990, 61 percent will terminate between 1990 and 1995, while 26 percent are scheduled to terminate after 1995.

DOE proposes to remove the price controls on old gas, allowing those prices to escalate to a market-clearing price, without doing anything about the above-market prices for new gas under contracts that do not have price-sensitive adjustment provisions and that will not expire until the 1990s. The result of this proposal, if adopted, is that pipelines would become contractually obligated to buy at prices that are further above market levels than they are now. Although DOE recognizes that

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[6] Foster Associates, supra, at p. 9.

this will occur, it reasons that market forces will drive those prices for gas under contracts to a market level. There are two problems with this reasoning. First, it ignores the fact that due to the limitations on access to pipeline transportation, such competition is available to reduce prices only to the segment of the market that is not held captive to purchase gas only from the pipeline company, as discussed in the transportation section above. Thus, between 1986 and 1990, due to the limits on access to firm transportation, pipelines could, and most assuredly would, pass through to residential and commercial consumers above-market prices for gas that, as a result of the DOE proposal, would be even higher than they would otherwise be.

Second, even if the discriminatory access problem were cured by adoption of the Bradley proposal, as we recommend, deregulating old gas prices without doing anything about the above-market prices under new gas contracts still would increase prices to consumers above a market-clearing level and would reduce demand for gas, production output and net economic efficiency. This is so because even if open competition forced pipelines to purchase gas under market-insensitive contracts only at a market price, which it has not been wholly successful in doing in the past, the pipeline still would be contractually liable to the producer for the difference between the contract price and the market price. This contractual liability, though disputed, will have to be paid by someone. It is well documented by the FERC and the DOE, that the producers have not absorbed all of the disputed amounts. Rather, pipelines have made substantial payments to producers to settle some of these contracts.[7] DOE's proposal, even if modified to prevent the above-market prices from being passed through to residential and commercial consumers, would require that all of these contracts be settled. Old gas prices would rise to a market level. New gas prices under both market-sensitive and non-market-sensitive contracts would be reduced by competition to a market level, but pipelines would have to pay the producers holding the favorable non-market-sensitive contracts some portion of the difference between the market price and the contract price in settlement of the contract claims. And, pursuant to FERC policy, these settlement expenses would be passed through in the transportation charges to the captive consumer markets.[8] Thus, simply stated, the proposal would create a transfer of wealth from consumers to producers.

The magnitude of this wealth transfer is evident by comparing the price of old gas and new gas for a number of interstate pipelines. Table 2 below shows that, based on DOE data, the average price of old and new gas for twenty major pipelines is $2.77 Mcf, about $1.00 Mcf, or 56 percent, above the current spot-market price. Old gas prices average $1.39 Mcf, while new gas prices average $3.82 Mcf. It is obvious that permitting producers to raise some old gas prices to a current market price of $1.75 Mcf,[9] without reducing the obligation of pipelines to pay those producers less than the $3.82 due under contracts for new gas, can only raise prices or, if competition forces pipelines to refuse delivery of the higher-priced gas, increase contractual take-or-pay liability to producers. Either way, consumers will be forced to pay higher -- above market -- prices for gas as a direct result of raising old gas prices.

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[7] Federal Energy Regulatory Commission, Order No. 436, Final Rule and Notice Requesting Supplemental Comments, Docket No. RM85-1-000, issued October 9, 1985, at p. IV.B.12.

[8] See, for example, Order No. 436, 50 Fed. Reg. at 42442.

The extent of the wealth transfer will be greater on some pipelines than others, but in every case, consumers will pay more for gas than its market value.

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[9] The price increase due to decontrol is not simply the difference between the market price and $1.39 Mcf, the average price of old gas. Rather, the price increase is equal to the difference between the market price and the average of only those old gas contracts that now are below the current market price. That average is well below $1.39. Under the Administration's bill, old gas that now is priced above market would be contractually fixed at the above-market price.

Table 2

Quantities and Average Prices for Wellhead Purchases of Natural Gas by Major Interstate Pipeline Companies 1984

Pipeline Name	Old Gas NGPA §§ 104/106(a) Purchases			New Gas			
	Total Old Interstate Gas		Old Gas Quantity as a Percent of Total	All Other NGPA Sections		Total	
	Quantity	Ave. Price		Quantity	Ave. Price	Quantity	Ave. Price
ANR Pipeline	296	1.54	62	182	4.40	478	2.63
Colorado Interstate Gas	145	0.80	53	127	3.61	272	2.11
Columbia Gas	183	2.37	31	401	4.67	584	3.95
Consolidated Gas Supply	40	1.60	23	133	3.72	173	3.23
El Paso Natural Gas	427	1.25	39	679	3.61	1,106	2.70
Florida Gas	58	0.85	28	149	3.55	207	2.80
K N Energy Inc.	51	0.82	65	27	3.41	78	1.71
Natural Gas	503	1.44	54	430	3.32	933	2.30
Northern Natural Gas	296	0.95	47	336	3.44	632	2.28
Northwest Central	159	0.97	63	94	4.07	253	2.12
Northwest	70	1.20	37	121	3.38	191	2.58
Panhandle Eastern	147	0.93	42	200	3.66	347	2.50
Southern Natural Gas	173	1.41	39	265	4.09	438	3.03
Tennessee Gas	420	1.80	49	430	3.88	851	2.85
Texas Eastern	287	0.70	40	437	3.50	724	2.39
Texas Gas	165	1.60	47	187	4.05	352	2.90
Transco	191	1.87	28	484	3.85	675	3.29
Transwestern	68	1.11	26	198	3.79	266	3.10
Trunkline Gas	169	1.82	53	147	5.64	316	3.60
United Gas	181	1.75	42	250	3.46	431	2.74
TOTAL	**4,029**	**1.39**	**43**	**5,276**	**3.82**	**9,305**	**2.77**

Source: Natural Gas Monthly, a DOE/EIA publication, January 1986, p. xxvi. The above pipelines serve such states as Colorado, Kansas, Oklahoma, Wyoming, New Jersey, New York, Pennsylvania, Maryland, the District of Columbia, Virginia, West Virginia, Ohio, Kentucky, Texas, New Mexico, Arizona, Nevada, California, Florida, Montana, Nebraska, Illinois, Indiana, Iowa, Missouri, Minnesota, Wisconsin, Michigan, South Dakota, Oregon, Idaho, Utah, Mississippi, Louisiana, South Carolina, Tennessee, Georgia, Alabama, Connecticut, Arkansas and North Carolina.

What effect would this wealth transfer have on consumers and on net economic efficiency? First, clearly, consumers would be worse off, since their total bill would have risen even further above a market price. Second, the above-market prices to consumers will reduce demand for gas, thereby reducing production output and economic efficiency.

This scenario can hardly be disputed by DOE. For in the last Congress, DOE proposed legislation to deregulate old gas prices but at the same time provided for the opportunity for new gas contracts to be renegotiated without any resulting contract liability and settlement payments. It did this by establishing a limited period of time during which either the seller of gas or the buyer of gas under such contracts could elect to terminate the arrangement if a satisfactory renegotiated substitute could not be arranged without contractual liability for doing so.[10/] That approach properly reflected the clear reality that neither fairness to consumers nor economic efficiency can result from deregulating old gas prices without undoing the consequences of the new gas contracts that were negotiated at above-market levels in reliance upon continued price controls of that old gas.

The contrast between the Administration's bill in the last Congress and its current proposal clearly shows that the current bill reflects not a proposal to have free-market forces operate in the gas industry, but rather one to artificially prop

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[10/] S. 615, Cong. Rec. 1732 (Col. 2); Section 315 (Take-or-Pay Limits) and Section 316(a) (Market-Out Provision). Id. at 1735-1736, 1739.

up prices to producers of natural gas at a time of falling oil prices. It is not a proposal to increase net economic efficiency, but, like the oil import tax proposal, is designed to protect the production industry from foreign competition, even though doing so would impair net economic efficiency. This proposal is far more damaging, however, to American consumers than was the oil import proposal, which at least would have spread the costs of subsidizing the production industry among consumers of _all_ energy products. Here, in contrast, the burden of the subsidy is focused heavily and unfairly on a discrete segment of the population -- the residential and commercial consumers of natural gas that cannot, because of the high, fixed cost sunk in gas furnaces, take advantage of falling oil prices and escape the burden of above-market prices for natural gas that surely will befall them as a result of this unbalanced proposal.

If DOE is willing to stand up to the production industry, as the Administration did with respect to the oil import tax proposal, we will give every consideration to supporting modifications of the proposal to further _true_ free-market objectives. But this proposal, which seeks instead unfairly to tax residential and commercial consumers with above-market prices for gas, is one we shall vigorously oppose. All those who are committed to the idea of substitution of free-market forces for regulation of the wellhead price should join us in opposition to the Administration's bill.

CONTRACT CARRIAGE COALITION COMPROMISE FOR NONDISCRIMINATORY TRANSPORTATION

A broad-based coalition of residential and industrial natural gas consumers, producers, and state utility regulators have agreed to support a legislative proposal for nondiscriminatory contract carriage. The compromise proposal is a hybrid of the McClure compromise language that is the subject of Senate negotiation and the Dingell/Sharp and Richardson/Broyhill bills. The compromise, which the coalition seeks to have included in any comprehensive gas bill, resolves certain concerns raised by some local distribution companies and pipelines about the contract carriage provisions now pending in the House and Senate. The proposal does not, however, address the question of whether transportation by local distribution companies should be subject to Federal jurisdiction.

Recent experience indicates that natural gas is now available for 10 to 30 percent less than pipelines are charging their customers. Yet pipeline refusal to transport gas to many distribution companies and end-users has prevented millions of gas customers from obtaining the benefits of lower gas prices. In addition, by facilitating the movement of gas supplies to meet demand, the contract carriage compromise will help to develop a competitive gas market which will force gas prices down to market clearing levels.

The reduction in gas prices will also increase the use of natural gas. By putting pipelines' idle capacity to productive use, the per unit cost of gas to all consumers will be reduced. Thus, the effect of competition in the natural gas markets, combined with increased usage of pipeline facilities, will result in significant consumer savings.

Set forth below is a description of the key provisions of the compromise which compares it to the House and Senate proposals.

1. Definition of Available Capacity

a. Senate (McClure) bill: Would limit the capacity which is available for contract carriage service to that pipeline capacity in excess of the capacity necessary to meet all maximum quantitie under all tariffs, licenses or certificates. In addition, under this bill, a proposed contract carriage customer could get access to pipeline capacity to the extent either (i) an local distribution company is obligated to provide the contract carriage customer service without interruption or (ii) the state agency or local distribution company authorizes the contract carriage customer to utilize capacity otherwise reserved to the local distribution company.

b. House bills: The Dingell/Sharp bill would leave to the FERC the determination of when a pipeline has available capacity, whereas the Richardson/Broyhill bill states that in determining whether available capacity exists, the FERC must take into account the sales volumes for current customers and those reasonably projected for the requested transportation period.

c. Compromise: The determination of available capacity provision would be the same as the Senate bill, but in addition the prospective contract carriage customer would be able to obtain interruptible capacity to the extent of the greater of the (i) difference between the pipeline's total capacity and average actual throughput over the previous three years or (ii) the difference between the pipeline's total capacity and reasonably foreseeable requirements of its existing customers. In addition, any contract carriage customer receiving interruptible service would be able to obtain firm service whenever firm capacity is available. Subsection (d).

2. Restrictions on by-passing local distribution companies.

a. Senate (McClure) bill: Would restrict the by-passing of local distribution companies for facilities historically served by the local distribution company unless the transportation has been agreed to by the state and the local distribution company. A facility that has received service within the past four years and is physically connected to a local distribution company would be deemed to be historically served.
b. House bills: The Richardson/Broyhill bill would subject any by-pass to an FERC Section 7 proceeding. In addition, in the Dingell-Sharp bill, the relevant state commission would be authorized to impose terms and conditions on the transportation.

c. Compromise: A facility that has been served during the past four years would not be permitted to bypass a local distribution company unless the state agency approves or the volumes are in excess to the maximum volumes sold during the past four years. This restriction on by-pass would not apply if (i) the state does not have a procedure under which the state agency will, within a time certain, require local distribution companies to provide nondiscriminatory transportation to the extent of available capacity or (ii) the state finds the local distribution company does not have sufficient capacity to transport the gas. Subsection (c).

3. Additional Changes

There are several additional provisions in the compromise bill included for the purpose of creating nondiscriminatory contract carriage while protecting pipelines, local distribution companies and their existing customers.

a. Prerequisites to obtaining transportation: The compromise would eliminate the burdensome preconditions that were in the Senate bill (i.e. that the contract carriage customer must show it was unable to find other satisfactory arrangements before it can obtain transportation and that it has made a good faith effort to negotiate a continuation of current service). Sub--sections (a) and (b).

b. Who can obtain transportation: The compromise would open transportation and storage service to all contract carriage customers described broadly to include producers, sellers, resellers, buyers, local distribution companies, owners, users, or agents thereof. Subsection (o)(4). The Senate bill would limit service to sellers or purchasers.

c. Contract carriage compensation: As in the Richardso Broyhill bill, the compromise would provide that pipelines can receive an "incentive allowance" of up to 3 cents per Mcf (5 cents if there are multiple pipelines) if the pipeline does not file an unreasonable protest. The incentive allowance would be in addition to a just and reasonable rate which would include an equitable percentage of the pipelines' fixed costs. The compromise would also include the provision contained in the House bill which permits a pipeline to charge less than its maximum allowable rates provided it does not discriminate and does not recoup the cost from other customers. Subsection (b)

d. Tying-up of capacity: The compromise would incorporate the House bill provisions on termination and reduction of allocated capacity, but makes clear that local distribution companies do not lose the contract carriage capacity allocated as a consequence of switching from system supply capacity. Subsection (l). The compromise bill would also contain a provision to prevent those requesting contract carriage service from unreasonably tying up capacity (in effect transferring the monopoly over transportation from the pipeline to another entity).

e. Take-or-pay relief: The compromise would permit a pipeline to reduce its take-or-pay obligations, ratably among all its purchase contracts, in the event the pipeline loses sales volumes due to contract carriage services.

* * * * *

Coalition members supporting the Contract Carriage compromise include:

- Illinois Commerce Commission
- National Association of State Utility Consumer Advocates (an association of the legal representatives of residential and commercial consumers in 39 states)
- Natural Gas Equal Access (a coalition of independent gas producers and trade associations)
- Committee for Equitable Transportation (a coalition of industrial gas consumers)
- Independent Petroleum Association of America
- Natural Gas Supply Association

STATEMENT OF
PAUL L. BIDERMAN
SECRETARY, ENERGY AND MINERALS DEPARTMENT
STATE OF NEW MEXICO

Delivered to
ENERGY AND NATURAL RESOURCES COMMITTEE
SENATE OF THE UNITED STATES

May 20, 1986

The State of New Mexico would like to thank the Committee for this opportunity to comment on an issue that is of vital importance to the State: repeal of a portion of the Powerplant and Industrial Fuel Use Act.

The State of New Mexico supports Congressional action that would increase demand for natural gas, enhance fuel mix options for utilities, and, potentially, bring rate relief to electricity consumers. We believe that the repeal of Section 201(1) of the Powerplant and Industrial Fuels Use Act would accomplish all three objectives -- and we support this repeal.

As a State that is financially dependent upon oil and gas revenues, we are currently faced with exceedingly severe budget problems. The effective and efficient operation of State government and of our educational institution is being threatened by the current drop in oil and gas prices. Consequently, we are very concerned that oil and gas prices be stabilized; and we believe that repeal of Section 201(1) of the Fuel Use Act will increase natural gas demand by industry and electric utilities and that such increased demand will help to stabilize natural gas prices.

As a State that historically has exported approximately 60% of our natural gas production to California, we have witnessed the tremendous competition between oil and gas in the California market; and we feel that consumers are well-served by this competition. Repeal of Section 201(1) of the Fuel Use Act will enhance that competition, with the result that consumers will gain from decreased electric utility bills in those areas served by utilities with oil- or gas-fired capacity. In that regard, some utilities have already determined that a desirable least-cost approach is to refurbish existing oil or gas powerplants to minimize capital expenditures, extend facility life, and reduce consumer costs.

We believe also that repeal of Section 201(1) will expand the strategic options for electric utility planning. The electric utility industry is faced with numerous uncertainties, ranging from demand forecasting and plant siting to nuclear acceptance and acid rain. Increased opportunities for oil or gas-fired generation could be a very good, short-term bridge over troubled waters.

The New Mexico Energy and Minerals Department, of which I am Secretary, specializes in energy resource planning for a State that produces oil, gas, coal, uranium, and geothermal energy. Therefore, I also must bring up one other important point: total repeal of the Fuel Use Act may appear to have many short-term benefits; but we must not forget that today's short-term solutions often become tomorrow's long-term problems. For example, oil and natural gas prices are relatively cheap today; but will they remain relatively cheap five, ten, or fifteen years from now? No one has that answer. Also, although we currently have relatively abundant supplies both of domestic oil and natural gas and of imported supplies from "friendly" nations like Canada and the United Kingdom, no one can be certain of such supplies in the future.

Consequently, the State of New Mexico believes that Section 201(2) should not be repealed. Future electric powerplants must be constructed with the capability to use coal on any other alternative fuel, as well as oil or gas, as a primary energy source. Such a requirement not only will continue to support the security interests of the United States, but also will provide the electric utility industry with options which ultimately will benefit the Nation's electricity consumers.

Thank you for the opportunity to submit this statement for the record.

AGD

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May 21, 1986

Senator James A. McClure
Chairman
Energy and Natural Resources Committee
Room 358
Dirksen Senate Office Building
1st & C Streets, N.E.
Washington, DC 20510

Dear Senator McClure:

Enclosed for the Committee's consideration and inclusion in its hearing record are copies of Associated Gas Distributors' summary and critique of the Administration's gas pricing and transportation proposals. AGD remains keenly interested in this subject and appreciates the opportunity to submit the enclosed material for the record.

Very truly yours,

Dana Contratto

Dana Contratto

Counsel for
Associated Gas Distributors

Enclosures

cc: All Members of the Senate Committee
on Energy and Natural Resources

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CRITIQUE OF THE TRANSPORTATION AND WELLHEAD PRICING PROVISIONS OF THE ADMINISTRATION'S "NATURAL GAS TRANSPORTATION AND REGULATORY REFORM ACT OF 1986"

May, 1986

Critique of the Transportation and Wellhead Pricing Provisions of the Administration's "Natural Gas Transportation and Regulatory Reform Act of 1986"

Title I -- Open Access to Transportation

This title consists of two provisions designed to broaden access to natural gas transportation. The first, Section 101, would broaden Section 311 of the Natural Gas Policy Act (NGPA) to authorize transportation by any interstate or intrastate pipeline on behalf of any person. The term "person" is broadly defined in current NGPA Section 2(26), and must be presumed to be all-inclusive. Like existing Section 311 transportation, this authority is not mandatory or necessarily self-implementing. Its scope and character would depend on the Commission regulations issued to implement it. The Commission retains its discretion under existing Section 311(c) to impose terms and conditions on Section 311 transportation.

The amendment would further provide that any pipeline (interstate or intrastate) that provides, or receives gas pursuant to, Section 311 transportation must provide such transportation "without discrimination". The term "discrimination" is not defined. Because it is different from the Natural Gas Act (NGA) term "unduly discriminatory or preferential" and the Order No. 436 term "undue discrimination or preference," precedents defining these latter terms would presumably be inapplicable. Moreover, a court construing the new term "discrimination" would probably conclude that Congress must have knowingly and intentionally used a different, broader term and that the new standard must proscribe more things than the NGA standard does. This could eliminate the flexibility that has existed under the NGA standard for pipelines to make rational, and thus not "undue", distinctions in service. The new, "without discrimination" standard, would also mean that pipelines would be subject to a different standard of conduct for their Section 311 transportation than for their Section 7 transportation. Depending on how broadly the Commission chose to implement the new Section 311 authority, of course, it could be that there would no longer be any Section 7 transportation.

The amendment also differs significantly from Order No. 436 in that no Section 311 transportation would be "grandfathered" (i.e. exempt from the non-discrimination requirement), and in that receiving gas pursuant to Section 311 transportation would also trigger the non-discrimination requirement. Thus, whereas under Order No. 436 only pipelines acting as transporters are inhibited by the shadow of this requirement, under this bill pipelines acting as either transporters or shippers would be.

The second part of the "open access" provision of the bill requires that, upon request by any person, the Commission shall direct an interstate pipeline (not an intrastate) to provide transportation service, unless the pipeline demonstrates to the Commission it is "incapable" of rendering the service. The all-important term "incapable" is not defined. The Commission may implement this provision by rule or on a case-by-case basis, but its implementation must be consistent with the fullest practicable use of capacity. Transportation rates will continue to be regulated under the Natural Gas Act "just and reasonable" standard. Further, "the pipeline shall provide this transportation service without discrimination."

This mandatory carriage provision poses a number of problems. First, as discussed above, the "discrimination" standard is new and different; the Commission's experience since 1938 has been with an undue discrimination standard. Second, the provision would appear to be triggered only by a request to the Commission, not a request to the pipeline. This could result in a flood of filings with the Commission and enormous Commission involvement in the processing of transportation requests that is now performed by the pipelines. There is no provision for Commission-prioritizing of these requests, or creation of a waiting list in the event of inadequate pipeline capacity. Early experience under Order No. 436 has shown these to be real, not hypothetical, problems. Thus, a later-coming shipper could get transportation by Commission order, ahead of earlier-coming shippers waiting in line at the pipeline but which did not file "requests" with the Commission.

It is not clear to what the statement "the pipeline shall provide this transportation service without discrimination" would apply. Literally, "this transportation service" is only that performed pursuant to a mandatory Commission order, not that performed voluntarily. It is also not clear what certificate authority would be used for this transportation. If it is Section 311 authority, then this non-discrimination provision is redundant. If it is Section 7 authority, then this mandatory carriage provision is not sufficiently integrated with the continuing need to obtain a certificate of public convenience and necessity.

Title II -- Removal of Wellhead Price Controls and Repeal of Jurisdiction Over First Sales

This title is designed to remove remaining price and non-price controls over first sales of natural gas. Price controls would be removed immediately from any contract executed after March 1, 1986, and from any contract renegotiated after March 1, 1986, if the renegotiated contract expressly provides that the price shall be deregulated. All price controls would be lifted on April 1, 1987.

The earlier decontrol date for renegotiated contracts may be intended as a way of conferring on pipelines some bargaining leverage -- to obtain a benefit such as take-or-pay relief in return for agreeing to early decontrol. But the addition of the April 1987 date for complete deregulation may have exactly the opposite effect. Knowing that they can obtain deregulated prices as soon as April 1987, producers will lose any incentive to trade for deregulation in the next year, especially as the months pass, and that date nears, without enactment of this bill.

In other words, the April 1987 decontrol provision both vitiates any positive incentive created by the renegotiation provision and destroys whatever incentive exists under the status quo for producers to negotiate contract concessions with pipeline-purchasers. The active renegotiations of price-controlled contracts could be expected to grind to a halt for the next year, and with them those renegotiations of high cost, decontrolled contracts that pipelines might have been able to renegotiate downwards in exchange for renegotiating upwards certain price-controlled contracts.

The proposed amendment to NGPA Section 601, which would remove remaining NGA, non-price regulation from first sales, is anomalous. First, it would leave two provisions, a Section 601(a)(1)(A) and a (B), where a single, combined provision would be clearer. Second, it would remove NGA regulation immediately, instead of on the two-stage schedule specified for price deregulation. The result would be that the Commission would have no power to implement or enforce the price controls that would remain in effect until April 1, 1987, because that power derives from NGA Sections 4 and 5.

Similarly, the bill would repeal immediately, instead of on April 1, 1987, the Commission's corresponding regulatory powers under existing NGPA Section 315 to specify the minimum duration of contracts and to provide for a pipelne right of first refusal. There is also no warrant for repealing existing Section 315(c) at any time. That provision simply confers on the Commission discretionary authority to require the filing of gas purchase contracts in an individual case or by rule. Even under the proposed legislation, this is a power that the Commission should have to enable it properly to enforce the law. In particular, it is a power that the Commission could need to determine whether contracts qualify for early price decontrol under the renegotiation provision (proposed NGPA Section 121(f)(2)).

The final section of Title II would create a new NGPA Section 315 entitled "Effect of Area Rate Clauses". This section would have several troubling and anomalous effects. Its stated purpose is to assure that the last, pre-deregulation maximum lawful price (MLP) for Section 104 and 106(a) ("old") gas would be deemed a contractually authorized, post-deregulation price under old gas contracts containing area rate clauses, so that old gas prices would not have to revert back to lower prices that may be required in these old contracts.

It is important to put this provision in context. Many old gas contracts contain pricing provisions stating that the price shall be a specific price per unit (usually less than $1.00), or whatever higher price is prescribed, authorized, approved, or permitted by the Federal Power Commission, FERC, or successor governmental authority, or, in some cases, Congress. This is what is generally understood by the term "area rate clause". Under both the NGPA and the proposed deregulation, a seller of gas may not collect any price unless that price is authorized by its contract. The Administration's fear is, apparently, that under these old contracts, in the absence of this new Section 315, the only contractually authorized price after decontrol would be a lower price provided in the contract. The Administration proposes, instead, to avoid the applicable contract and make the most recent MLP (say, $2.50) a contractually authorized price.

This step is both foolish and ill-advised. The way many area rate clauses are worded, the provision is simply unnecessary, because under decontrol the free market price will fit the definition of a "higher price that is authorized, approved, or permitted by the FERC or Congress". The bill does not define the critical term "area rate clause". It must be something different from the term "indefinite price escalator clause", which is also used in proposed Section 315 and which is a defined term in NGPA Section 105(b)(3)(B). Without saying so, the drafters apparently intend the words "a Federally established rate or price" to cover whatever language appears in various area rate clauses. It is not at all clear, however, that a court would so hold.

As drafted, proposed Section 315 would make "the last price paid" prior to decontrol -- not the last effective MLP -- a contractually authorized post-decontrol price. This could have the effect of driving any old gas prices that are now lower than the MLP up above market rates now being paid simply to assure that they are at the MLP on the day before passage of this amendment. As drafted, the provision would then hold old gas prices at the, say, $2.50 level after decontrol; that would be deemed a "higher price prescribed or approved by FERC or Congress", and it would be the contract price until the contract could be renegotiated. Far from free market pricing under deregulation, this would be nothing more than Congressionally prescribed, artificially high prices.

The proposed Section 315 would apply only to old gas contracts that contain no other indefinite price escalator besides the area rate clause, and that were executed at a time when any indefinite price escalator other than an area rate clause was illegal. This appears to be a reference to a FERC regulation, 18 C.F.R. § 154.93, but the provision poses a great many problems.

The provision appears to be intended to allow for the fact that a great many gas supply contracts contain both an area rate clause and another clause setting out the price terms in the event of deregulation. These deregulation provisions typically provide for periodic renegotiations in the event that federal price controls cease to apply. If a contract contains such a clause, it should clearly be honored; hence, the amendment creating a $2.50 contract price does not apply to such a contract. But even if a contract does not contain a deregulation clause, the point is that it could have if the parties had so desired. After nearly three decades of constant discussion of Congressional decontrol, contracts that still make no provision for decontrol must be presumed to do so because the parties decided not to, not because the parties never considered the possibility. There can be no excuse for legislating contract language instead of honoring existing contractual intent.

The suggested excuse is that the parties may have been prohibited from including a deregulation provision that they would have liked to include. But the regulation in question does not use the phrase "area rate clause" or the word "proscribed." It went into effect in 1962, stopped being enforced at an unspecified time very soon thereafter, and yet is still on the books. It was never construed literally and was, instead, generally construed to permit the widest possible range of escalators referring to federally regulated prices. In any event, it is indisputable that for many years now FERC has permitted all manner of indefinite escalator clauses. Yet it would be exceedingly difficult to attach dates to "a time when" other indefinite escalator clauses were proscribed.

Moreover, the proposed language covers "a contract . . . that was executed at a time when . . . ." The issue should be when the contract's pricing provisions were most recently amended, not when the underlying contract was first executed. Further, since it has for many years been possible to amend contracts to include virtually any kind of escalator provision, even those contracts that were last amended at a time when such clauses were proscribed (whenever that was) could have been amended more recently, had the parties so desired, to cover the eventuality of deregulation.

In other words, the key is the intent of the parties. Although advocates of decontrol pay great lip service to the freedom to contract and the sanctity of contracts, what proposed Section 315 does is substitute Congressionally mandated high prices for what the parties actually intended. This is indefensible.

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SUMMARY OF THE ADMINISTRATION'S "NATURAL GAS TRANSPORTATION AND REGULATORY REFORM ACT OF 1986"

May, 1986

Summary of The Administration's "Natural Gas Transportation and Regulatory Reform Act of 1986"

Title I -- Open Access to Transportation

This title consists of two provisions designed to broaden access to natural gas transportation. The first provision, Section 101, would amend NGPA Section 311(a) to provide that the Commission may, by rule or order, authorize any interstate or intrastate pipeline to transport gas on behalf of "any person". The amendment would retain the current separate rate provisions of NGPA Section 311(a), i.e. that transportation rates charged by interstate pipelines must be just and reasonable, while those charged by intrastate pipelines must be fair and equitable. The amendment would then add a requirement that any pipeline which provides Section 311 transportation, or which receives gas pursuant to Section 311, shall provide Section 311 transportation "without discrimination".

The second provision, Section 102, would create a new NGPA Section 316, which would require that, upon request of any person, the Commission shall direct an interstate pipeline to provide transportation service, unless the pipeline demonstrates that it is "incapable" of rendering the service. The interstate pipeline shall provide this transportation service "without discrimination." The transportation rates for this service would be regulated according to the just and reasonable standard of the Natural Gas Act. Lastly, the section provides that Commission implementation of this section, which may be by rule or order, should be consistent with the fullest practicable use of pipeline capacity.

Title II -- Removal of Wellhead Price Controls and Repeal of Jurisdiction Over First Sales

This title is designed to remove remaining price and non-price controls over first sales of natural gas. Section 201 would remove price controls in two phases: immediately from any gas subject to a contract executed or renegotiated after March 1, 1986, and in any event no later than April 1, 1987 for all gas.

Section 202 would amend NGPA Section 601 to remove from non-price, NGA regulation all first sales of natural gas. NGPA Section 315, which provides for minimum contract duration, a pipeline right of first refusal, and Commission power to order pipelines to file their gas supply contracts, would be repealed, and new NGPA Section 315, entitled "Effect of Area Rate Clauses", would be added. This new section would provide that the last, pre-deregulation maximum lawful price for Section 104 and 106(a) gas ("old gas") would be deemed a contractually authorized, post-deregulation price under contracts for Section 104 and 106(a) gas containing area rate clauses. The intended effect of this provision is that, upon deregulation, old gas prices would not roll back to what may be lower contract levels, but rather would stay at the 1987 levels.

Title III -- Repeal of Certain Restrictions on Natural Gas and Petroleum Use and Pricing

In brief, the Fuel Use Act, excepting provisions related to prohibition orders, would be largely repealed. Also, NGPA Title II, relating to incremental pricing, would be repealed.

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President
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May 21, 1986

Senator James A. McClure
Chairman, Senate Energy Committee
358 Dirksen Office Building
Washington, DC 20510

Dear Mr. Chairman:

As you know, the National Coal Association has a strong interest in the decontrol of natural gas, having had several opportunities to testify before your committee on this important subject.

Yesterday's hearing was no exception, but unfortunately our request to testify was not honored due to a pressing committee schedule. We were assured by staff, however, that we were among "distinguished company" that did not make the witness list.

Nonetheless, this issue is of prime concern to the coal industry, since major shifts in overall energy policy are felt by all energy producers even if the policy changes are confined to a single producing segment.

Consequently, we are enclosing a copy of the testimony we would have delivered to the committee along with a one-page summary of its contents. Your staff has assured us that our remarks will be included in the official record, but we want to reconfirm our strong interest in this issue, and in any legislation that may be considered by Congress.

Sincerely,

Carl Bagge

Carl E. Bagge

Enclosure

cc: Energy Committee Members

1130 Seventeenth Street, N.W.
Washington, D.C. 20036-4677
(202) 463-2625

SUMMARY OF THE NATIONAL COAL ASSOCIATION'S WRITTEN TESTIMONY ON NATURAL GAS DECONTROL AND S.2205's PROPOSED CHANGES TO THE POWERPLANT AND INDUSTRIAL FUEL USE ACT (PIFUA).

1. The coal industry supports the removal of all well-head price controls on natural gas.

2. EXISTING BOILERS FACE ABSOLUTELY NO LEGAL OR REGULATORY BARRIERS TO THE USE OF NATURAL GAS. THE ONLY PIFUA RESTRICTION IS THE ONE THAT PREVENTS THE USE OF NATURAL GAS IN NEW BOILERS.

3. Any reexamination of PIFUA should take into account three fundamental forces impacting today's energy markets.

   a. First, the current regulatory environment has resulted in a growing aversion of electric utilities to building new capital-intensive coal-fired plants, even though they are clearly the cheapest alternative in the long run.

   b. Second, as a sheer engineering matter, once a boiler is built to burn gas only, it cannot be converted to use other fuels, principally coal. The converse is not true -- a coal-capable boiler can be rapidly and inexpensively converted to use gas.

   c. Third, the domestic and international energy markets are highly volatile, and it is not unlikely to expect the relative price of gas to resume its climb sometime in the not too distant future.

4. Repeal of the PIFUA requirement that new boilers be coal-capable is not warranted and most likely will be viewed as a mistake in the future.

NATIONAL COAL ASSOCIATION

Statement of

A. Denny Ellerman
Executive Vice President
National Coal Association

On the Repeal of the Powerplant & Industrial
Fuel Use Act (PIFUA)

before the

U.S. Senate Energy and Natural Resources Committee

May 20, 1986

Mr. Chairman, I'm Denny Ellerman, Executive Vice President of the National Coal Association. Thank you for giving me the opportunity to appear today and give the coal industry's views on the issue of natural gas decontrol and the proposed changes to the Powerplant and Industrial Fuel Use Act (PIFUA) contained in S. 2205. I will be brief and confine myself to repeal of PIFUA. But first, let me say at the outset that the coal industry supports the removal of all well-head price controls on natural gas. Over thirty years of price controls has demonstrated the inability -- indeed, folly -- of the government attempting to control prices in the public interest, particularly for such a key commodity as natural gas.

Mr. Chairman, as you know, PIFUA was passed at the height of the energy crisis hysteria, and I believe a lot of confusion still exists over what the Act does and does not allow in terms of natural gas usage. The key point is that existing boilers face absolutely no legal or regulatory barriers to the use of natural gas.

o First, as you know, the so-called "off-gas" provision applying to existing boilers of PIFUA was repealed in 1981, which was the major force in the Act to move large amounts of gas out from under large industrial and utility boilers.

- Hence, the only PIFUA restriction is the one that prevents the use of natural gas in new boilers. PIFUA also requires those boilers to be built "coal-capable."
- Third, this requirement does not appear to be presenting a real problem for those new plants desiring to use gas, given the various exemptions in the law which are routinely granted by the Department of Energy.

Mr. Chairman, any such reexamination of PIFUA should take into account three fundamental forces impacting today's energy markets. First, the current regulatory environment of second guessing utility decisions, primarily at the state level, is resulting in a growing aversion of electric utilities to building new capital-intensive coal-fired coal plants, which, over the life of the plant, is clearly the cheapest alternative. Instead, less capital-intensive gas-fired plants are being used to meet new demand. While such power plants might be economic at today's natural gas prices, few expect these price relationships to hold over the next two, three or even four decades, which is the lifetime of these power plants. Repeal of PIFUA would undoubtedly hasten this trend to less capital-intensive but more fuel-intensive generating facilities in this country.

Second, as a sheer engineering matter, once a boiler is built to burn gas only, it cannot be converted to use other fuels, principally coal. The opposite is not true -- a coal-capable boiler can be rapidly and inexpensively converted to use gas. The architects of PIFUA in the previous administration learned this painful lesson in the early days of the infamous "coal conversion" programs of the mid 1970s, when natural gas supplies were rapidly dwindling, and much of the generating capacity simply could not be converted.

Third, the domestic and international energy markets have been for the last decade and most likely will continue in the future to be highly volatile. While the price of gas relative to coal has recently turned favorable, returning more to the historic relationships of the early 1970s, most observers, including non-experts such as myself, expect the relative price of gas to resume its climb sometime in the not too distant future.

For these reasons, Mr. Chairman, I believe it is absolutely essential for formulators of national energy policy such as yourself to carefully consider the future impacts of any decisions made today that are based upon the vagaries of the current price and supply situation. Repeal of the requirement that new boilers be coal-capable is, in my view, not warranted and most likely will be viewed as a mistake in the future, since current regulatory and price relationships will inevitably lead to a stock of generating capacity that is incapable of responding to future changes in energy supply and demand.

Mr. Chairman, thank you very much for this opportunity to appear today.

ENR
Illinois Department of
Energy and Natural Resources

325 W. Adams St. Room 300
Springfield IL 62706

June 2, 1986

The Honorable Don Nickles
Chairman
Subcommittee on Energy Regulation and Conservation
Committee on Energy and Natural Resources
212 Hart Building
Washington, D.C. 20510

Dear Senator Nickles:

I am writing today to address S. 2285, the Natural Gas Amendments of 1986. I commend you and members of the subcommittee for your dedicated work in drafting legislation that is meant to create a fair market for the natural gas industry and benefit the U.S. citizenry.

Under my direction, the Illinois Department of Energy and Natural Resources, serving as the state's energy office, has historically taken an active role in assessing state and federal natural gas and related issues. After careful study, the Department of Energy and Natural Resources supports the first and third components of S. 2285, open access to transportation on a non-discriminatory basis, and repeal of certain provisions of the Fuel Use Act and Incremental Pricing Provision of the Natural Gas Policy Act of 1978. However, the Department of Energy and Natural Resources opposes the second component of the bill, decontrol of first sales of all natural gas by April, 1987 for the reasons stated in the attached analysis.

Thank you.

Sincerely,

Don Etchison
Director

Attachments

State of Illinois--Department of Energy and Natural Resources

AN ANALYSIS OF NATURAL GAS POLICY ACT AMENDMENTS OF 1986

INTRODUCTION

The bill has three components. These are: (1) Open access to transportation on a non-discriminatory basis, (2) decontrol of first sales of all natural gas by April, 1987, and (3) repeal of certain provisions of the Fuel Use Act and the Incremental Pricing Provision of the Natural Gas Policy Act of 1978. While there is universal support for the first and third components of the bill, the second component is more controversial. The Illinois Department of Energy and Natural Resources strongly supports the first and third components of the bill, while making its support for the second component conditional on certain revisions.

ANALYSIS

Access to transportation: The lack of access to transportation services is one of the major obstacles for competitive gas markets. Both, under the NGPA and NGA, interstate pipelines are private carriers engaged in transportation of gas on a voluntary basis. They perform two functions -- transportation and marketing. The transportation function is a natural monopoly. Gas marketing, on the other hand, is potentially competitive. By virtue of being private carriers, pipelines can deny transportation of gas they do not own. By denying access to pipeline transportation to their potential competitors, pipelines are able to extend their monopoly in transportation to marketing as well. Thus, pipelines enjoy tremendous monopolistic power at both ends of the system -- wellhead and burnertip.

As a result of increasing pressure from both Congress and the Administration, the Federal Energy Regulatory Commission promulgated on October 18, 1985, new rules and regulations relating to natural gas transportation services. One of the major thrusts of these new rules and regulations is to create competitive conditions in the natural gas markets by providing all consumers and producers equal access to natural gas transportation services.

Most pipelines are refusing, however, to transport gas for third parties thus denying the consumers and producers alike the economic benefits of the truly competitive gas market. Frustrated with the intransience of pipelines, the Congress also expressed their sense in the form of a non-binding resolution that natural gas pipelines should transport natural gas in a non-discriminatory manner.

In light of these developments, the present bill is timely and the open access components of it deserves unqualified support of ENR.

Repeal of the Fuel Use Act and Incremental Pricing Provisions: The premises under which both the Fuel Use Act and the Incremental Pricing Provision of the NGPA were enacted are no longer valid. They were enacted during a period of low supplies of natural gas. But now there is an oversupply. The Fuel Use Act has never been enforced. It does not make sense to keep it on the books.

In addition, the closing of the gap between the prices of natural gas and its alternative fuels has rendered the incremental pricing provision to become an impediment to natural gas markets.

Moreover, the recent changes in the Federal Energy Regulatory Commission's regulations requiring the natural gas pipelines to transport gas for third parties has enabled industrial users to buy their gas directly, either from producers or on the spot market, and force the pipeline's to transport the gas. The loss of industrial customers to the local distribution companies could adversely affect the residential commercial customers. Thus, as open access becomes a reality, incremental pricing will lose any validity it may have because it unfairly penalizes sales efforts by pipelines and distributors. Also, gas markets are threatened with load loss to alternate fuels due to the precipitous drop in oil prices this year. Imposing incremental pricing surcharges negates the principles of competitive markets. This legislation would open a market to natural gas that has been deprived of the fuel. Hence ENR should support repeal of the Fuel Use Act and Incremental Pricing.

Decontrol of Old Gas: While the economic advantages of open access to transportation and the repeal of the Fuel Use Act and Incremental Pricing Provisions are clear and nearly universally supported, the economic benefits assumed to accrue from decontrol of old gas are theoretical and hold good only in an ideal and competitive market situation. Unfortunately, the present day gas markets are anything but competitive. They suffer from serious contract rigidities which have been inherited from the past. Much of today's new gas is locked into long-term contracts with a variety of "sweet" deals such as "take or pay" that are unrelated to market conditions. Any attempt to redefine the market relationships disregarding the contract terms that govern these relationships is bound to have uneven consequences for different segments of the industry.

The "sweet" deal contract provisions entered into between producers and pipeline companies on the one hand, and between distributors and pipeline companies on the other have presented serious problems in the recent past. The rigid take provisions, for instance, have prevented the natural gas industry from being able to respond quickly to changes in the economic development. Pipelines have had to continue to purchase higher cost gas because of take-or-pay requirements, instead of purchasing lower cost gas available to them. There is no incentive for pipelines to provide least cost mix of gas, since they are allowed by regulation to pass on all purchased gas costs to their customers. This behavior on the part of pipelines contributed, in part, to the present market distortions, gas surplus, high prices, depressed demand and enormous take-or-pay liabilities. The problem is being aggravated due to lack of access to available transportation services. Thus, the various contract provisions have remained a major stumbling block for competitive gas markets. Decontrol of old gas without addressing the contract rigidities would not help create competitive markets.

The assertion made by the proponents of the bill that the price of old gas will come down is questionable because it is all based entirely on the theory of free market prices and ignores the contractual situation that exists in the industry. The bill, instead, would increase producer's cash flow which might have an impact on the decisions producers make whether to stand on their contract rights and litigate or renegotiate. Congress has the responsibility to ensure that high-priced contracts can be renegotiated downward simultaneously with any increase in price that could result from decontrol of old gas.

Therefore, the Illinois Department of Energy and Natural Resources would support decontrol legislation that incorporates contract renegotiation language. Specifically, producers should be allowed to charge free market prices for old gas, provided that they renegotiate all of their existing contracts to ensure free market prices for new gas as well.

TABLE 1: APPROXIMATE VOLUMES OF NATURAL GAS
SOLD IN ILLINOIS BY INTERSTATE PIPELINES IN 1983

Interstate Pipelines	Total Gas Sold (in BcF/yr)	Old Gas, i.e.* 104,105,106 & 109 Sold (in BcF/yr)	% of Total Gas
ANR	1.5	0.9	60
Midwestern	115.2	42.8	37.2
NGPL	681.6	332.8	48.8
Northern	39.1	21.6	55.2
Panhandle	77.7	39.9	51.4
Texas Eastern	12.3	6.4	52.0
Texas Gas	9.4	5.2	55.3
Trunkline	7.5	6.5	86.7
Total	944.2	456.1	48.3

*(1) FERC Purchased Gas Adjustments Forms filed with the FERC consists of gas quantities by Natural Gas Policy Act Category. Sales and purchases among interstate pipelines are derived from Form 2 filed with the FERC.

(2) See also, Block Billing of Natural Gas by Robert A. Leone, September, 1985, John F. Kennedy School of Government, Harvard University.

TABLE 2: APPROXIMATE VOLUMES OF NATURAL GAS PURCHASED BY UTILITIES IN ILLINOIS IN 1983

Distributors	Total Gas (BcF/yr) Purchased	Old Gas, i.e.* 104,105,106 & 109 Purchased (BcF/yr)	
Illinois Power	64.21	32.54	50.7%
Interstate Power	19.89	9.73	48.9%
Iowa-Illinois	25.63	12.88	50.3%
North Shore	32.12	15.68	48.8%
NI Gas	444.53	210.76	47.4%
Peoples	264.67	124.27	47.0%
CIPS	34.27	18.81	55.0%
Consumers Gas	1.10	0.57	51.8%
CILCO	39.72	20.58	51.8%
United Cities	4.13	2.48	60.0%
Illinois Gas	1.60	0.89	55.6%
All others	12.28	6.83	55.6%
Total	944.2	445.92	48.3%

*(1) FERC Purchased Gas Adjustments Forms filed with the FERC consists of gas quantities by Natural Gas Policy Act Category. Sales and purchases among interstate pipelines are derived from Form 2 filed with the FERC.

(2) See also, Block Billing of Natural Gas by Robert A. Leone, September, 1985, John F. Kennedy School of Government, Harvard University.